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How Omnicare V. Laborers Reached The High Court

Law360, New York (April 03, 2014, 2:53 PM ET) -- On March 3, 2014, the U.S. Supreme Court agreed to hear the case of Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, (13-435)[1] to resolve the question of whether, for purposes of a Section 11[2] claim, it is sufficient for a plaintiff to plead that a statement of opinion was untrue by only alleging that the opinion was objectively false, or if they also needed to allege that the statement was subjectively false (i.e., the speaker knew the opinion was false when made).

When corporate officers comment on opinions, like a company's estimates of goodwill or loan loss reserves, as long as their statements were honestly believed, corporate officers could expect to extricate themselves from a securities class action at the pleading stage even where their statements later turned out to be incorrect.

That was, until July 23, 2013, when the Sixth Circuit broke with the Ninth and Second Circuits, and allowed a complaint based on Section 11 to proceed where the plaintiffs' alleged that various corporate statements of opinion were objectively false, while disclaiming that the statements were subjectively false.[3]

The case before the Sixth Circuit was based on opinion statements that Omnicare made in a 2005 registration statement that its contracts with drug companies were "legally and economically valid arrangements …"[4] In January 2006, several government raids were conducted on Omnicare facilities that resulted in two large settlements.[5] Plaintiffs' sued the company, its CEO, CFO, secretary, chairman of the board, and one of its directors claiming that given Omnicare's alleged illegal activities, its prior statements regarding "legal compliance" were false when made. In the most recent appeal[6], the plaintiffs successfully argued that even though they did not allege that either Omnicare or its corporate officers held opinions different from the ones expressed, their case should proceed under the strict liability provisions of Section 11.

Rejecting Omnicare's argument that the court's prior analysis of this "soft information" under Section 10(b) of the Exchange Act[7] should apply equally to the plaintiffs' Section 11 claims, the court stated:

Section 10(b) and Rule 10b–5 require a plaintiff to prove scienter, § 11 is a strict liability statute. It makes sense that a defendant cannot be liable for a fraudulent misstatement or omission under § 10(b) and Rule 10b–5 if he did not know a statement was false at the time it was made. The statement cannot be fraudulent if the defendant did not know it was false. Section § 11, however, provides for strict liability when a registration statement "contain[s] an untrue statement of a material fact." … No matter the framing, once a false statement has been made, a defendant's knowledge is not relevant to a strict liability claim.[8]

In reversing the district court's dismissal of the Section 11 claims, the Sixth Circuit also expressly declined to follow the pleading standard set forth by the Ninth Circuit in Rubke[9], and the Second Circuit in Fait[10], both based on the Supreme Court's opinion in Virginia Bankshares[11], concluding that "[t]he Second and Ninth Circuits have read more into Virginia Bankshares than the language of the opinion allows and have stretched to extend this § 14(a) case into a § 11 context."[12]

The split between circuits stems from differing interpretations of the Supreme Court's opinion in Virginia Bankshares. In Virginia Bankshares, minority shareholders sued bank directors for misleading proxy statements under Section 14(a) of the Exchange Act[13] after a "freeze-out" merger, alleging that the directors falsely stated that shareholders were offered a "high" value and a "fair" price for their stock.[14] The minority shareholders also alleged that the directors did not believe these statements when they were made.

The court determined that the statements of "high" value and a "fair" price, while not statements of fact, were "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."[15]

Based on this analysis, the court concluded that the opinion statements made by the directors were actionable under Section 14(a) where they misstate the opinions or beliefs held, or, in the case of statements of reasons, the motivation for the speaker's actions, and are objectively false or misleading.[16]

In his concurring opinion, Justice Antonin Scalia summarized the court's opinion as follows:

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.[17]

In Rubke[18], Capital Bancorp Ltd, and its CEO were sued under Sections 11, 10(b), and 14(e), based upon allegations that certain information contained in offering documents sent to minority shareholders that induced them to exchange shares in a tender offer was misleading. Included in the allegations was that "Capitol's registration statement mislead the … minority shareholders by incorporating two fairness opinions … concluding that the transaction was 'financially fair' to the minority shareholders."[19]

Relying on Virginia Bankshares, the Ninth Circuit affirmed the district court's dismissal holding that "[b]ecause these fairness determinations are alleged to be misleading opinions, not statements of fact, they 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."[20]

In Fait[21], Regions Financial Corporation, its subsidiary, directors, auditor and underwriter were sued under Sections 11 and 12(a), based on allegations that following a merger; Regions "failed to write down 'goodwill' and to sufficiently increase 'loan loss reserves'" and that, as a result, Regions' offering documents "contained 'negligently false and misleading' statements concerning goodwill and loan loss reserves."[22]

Relying on Virginia Bankshares[23], the Second Circuit affirmed the district court's dismissal holding that "when a plaintiff asserts a claim under section 11 or 12 based upon a belief or opinion alleged to have

been communicated by a defendant, liability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed."[24] Fait's requirement that plaintiffs plead both objective and subjective falsity in Section 11 claims has become settled law in the Second Circuit.[25]

As Omnicare stated in its Supreme Court petition, "[u]nder the Sixth Circuit's approach, many potential speakers — including issuers, officers, directors, auditors, lawyers, and underwriters — may find themselves vulnerable to claims based on hindsight, as potential plaintiffs and class counsel focus their efforts on statements of opinion that, over time, turn out to be wrong."[26]

Corporate officers will be watching the Supreme Court's decision next term in Omnicare to determine whether their honestly stated opinions, which later turn out to be incorrect, form a sufficient basis for pleadings based on the strict liability provisions of Section 11.

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[1] Indiana State Dist. Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc., 719 F.3d 498, 501 (6th Cir. 2013) cert. granted, 13-435, 2014 WL 801097 (U.S. Mar. 3, 2014)("Omnicare II").

[2] Section 11 of the Securities Act of 1933 ("Section 11") provides a private remedy for securities purchasers if the registration statement "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 statement therein not misleading." 15 U.S.C. § 77k. Section 11 claims do not require scienter — or intent to deceive.

[3] Omnicare, 719 F.3d at 501.

[4] Id. (emphasis original).

[5] See e.g., Indiana State Dist. Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc., 583 F.3d 935, 941 (6th Cir. 2009)("Omnicare I").

[6] In Omnicare I, the Court upheld the dismissal of Section 10(b) claims stating that "the complaint fails specifically to allege that defendants knew their statements of 'legal compliance' were false when made," and remanded the Section 11 claims. Id. 583 F.3d at 946.

[7] Section 10(b) of the Exchange Act of 1934 requires scienter – or intent to deceive. 15 U.S.C. § 78j.

[8] Omnicare, 719 F.3d at 505 (citations omitted).

[9] Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156 (9th Cir. 2009).

[10] Fait v. Regions Financial Corp., 655 F.3d 105 (2d Cir. 2011).

[11] Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991).

[12] Omnicare, 719 F.3d at 506.

[13] 15 U.S.C. § 78n.

[14] Omnicare, 501 U.S. at 1088.

[15] Id. 501 U.S. at 1092-93.

[16] Id. 501 U.S. at 1095-96 ("disbelief or undisclosed motivation, standing alone, [is] insufficient to satisfy the elements of fact that must be established under § 14(a).").

[17] Id. 501 U.S. at 1108-09.

[18] Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156 (9th Cir. 2009).

[19] Id. 551 F.3d at 1161-62.

[20] Id. 551 F.3d at 1162 (citing Virginia Bankshares).

[21] Fait v. Regions Financial Corp., 655 F.3d 105 (2d Cir. 2011).

[22] Id. 655 F.3d at 108.

[23] Virginia Bankshares, 501 U.S. at 1090–96.

[24] Fait, 655 F.3d at 110 (citing Virginia Bankshares).

[25] See e.g., Freeman Grp. v. Royal Bank of Scotland Grp. PLC, 540 F. App'x 33, 37 (2d Cir. 2013); Freidus v. ING Group, N.V., 543 F. App'x 93, 95 (2d Cir. 2013); Freidus v. Barclays Bank PLC, 734 F.3d 132, 141 (2d Cir. 2013)(all citing Fait).

[26] Petitioner's Application, p. 15.
