COHEN MILSTEIN

Supreme Court to Decide Whether Subjective Falsity is Required for Section 11 Claims

On March 3, 2014 the U.S. Supreme Court granted *certiorari* in *Indiana State District Council of Laborers v. Omnicare* ("Omnicare"), 13-435, to resolve the following question:

> For purposes of a Section 11 claim, may a plaintiff plead that a statement of opinion was 'untrue' merely by alleging that the opinion itself was objectively wrong, as the Sixth Circuit concluded, or must the plaintiff also allege that the statement was subjectively false—requiring allegations that the speaker's actual opinion was different from the one expressed—as the Second, Third, and Ninth Circuits have held?

Put simply, the question is whether a plaintiff asserting a Section 11 claim must allege only that a statement of opinion was objectively false, or whether the plaintiff must allege that the statement was both actually false and the defendant did not believe the opinion when he or she said it. The case is potentially important because if the Court affirms the Sixth Circuit, knowledge of falsity would no longer be required in the Second, Third, and Ninth Circuits, giving Section 11 claims renewed vitality—particularly at the motion to dismiss stage.

Background

Omnicare is the country's largest provider of pharmaceutical care services to long-term care facilities. The plaintiffs in the action are investors who purchased Omnicare securities in a December 15, 2005 public offering. Plaintiffs allege that the registration statement filed in conjunction with the offering contained materially false and misleading statements. In particular, plaintiffs allege that statements concerning the legal validity of Omnicare's contracts with drug companies were materially false and misleading because Omnicare was involved in a variety of illegal activities, including kickback arrangements with pharmaceutical manufactures and the submission of false claims to Medicare and Medicaid.

The case, which was filed in February 2006, has a complex procedural history, including two trips to the 6th Circuit and a prior *certiorari* petition to the Supreme Court that the plaintiffs eventually voluntarily dismissed. The most recent appeal to the Sixth Circuit occurred after the district court dismissed plaintiffs' Section 11 claim on the basis that plaintiffs failed to plead knowledge of falsity on behalf of the defendants. Plaintiffs appealed and the Sixth Circuit reversed, holding in relevant part that because Section 11 imposes strict liability "once a false statement has been made, a defendant's knowledge is not relevant." 719 F.3d 498, 505 (6th Cir. 2013). The court further explained "[u]nder Section 11 . . . if the

defendant discloses information that includes a material misstatement, that is sufficient and a complaint may survive a motion to dismiss without pleading knowledge of falsity." *Id.*

The Sixth Circuit's ruling was an express departure from decisions in the Second and Ninth Circuits, which have relied on the Supreme Court's opinion in *Virginia Bankshares v. Sandberg* to require Section 11 plaintiffs to plead both objective and subjective falsity for statements of opinion. *Id.* at 505-07. But, the Sixth Circuit reasoned that Second and Ninth Circuits got it wrong because *Virginia Bankshares*, a case concerning Section 14(a), does not apply to Section 11 cases. The three-judge panel explained, "[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." *Id.* at 506. Ultimately, the Sixth Circuit concluded "it would be unwise for this Court to add an element to § 11 based on little more than a tea-leaf reading in a § 14(a) case." *Id.* at 507.

Omnicare filed a petition for *certiorari*, urging the Supreme Court to grant the petition in order to resolve the circuit split. Omnicare also argued that "[t]he Sixth Circuit's approach on this issue threatens dangerous and far-reaching consequences. Among other things it portends a shift away from the clear limitation this court and Congress have placed on claims under the federal securities laws." Brief of Petitioner Omnicare at 2, *Omnicare, Inc., et al., v. The Laborers District Council Construction Industry Pension Fund and the Cement Masons Local 526 Combined Funds*, No. 13-435 (6th Cir. May 23, 2013).

Discussion and Implications

The case is significant because, as noted above, Section 11 imposes strict liability for all issuers, directors, officers, underwriters, and experts who make a material misstatement in a registration statement. Requiring knowledge of falsity on behalf of the defendant essentially does away with strict liability and imposes a scienter (*i.e.*, culpable state of mind) requirement for Section 11 claims. This is not a trivial change—pleading scienter is difficult and having to do so for each Section 11 claim would significantly increase the burden on plaintiffs at the motion to dismiss stage.

The case also has important implications when considered in connection with the Court's review of the fraud-on-the-market presumption in *Halliburton II*. If the Court completely overturns the presumption, (which we think is unlikely, but not impossible, as discussed in our accompanying analysis of the oral argument in *Halliburton II*), Section 11 claims will become an even more important vehicle for securities class actions,[1] making the Court's adoption of the Sixth Circuit's more relaxed standard even more critical.

[1] This is because the fraud-on-the-market presumption only applies to Section 10(b) and Rule 10b-5 claims.

As a practical matter, we currently litigate many of our cases in the Second and Ninth Circuit and are already familiar with what is required to successfully meet the heightened pleading standard for Section 11 claims that those Circuits impose. Thus, while we are hopeful the Court will affirm the Sixth Circuit's more relaxed standard, we are prepared in the event that the Second and Ninth Circuit pleading standard will prevail.

The Court is scheduled to hear the case in October 2014.