Bloomberg BNA

Corporate Law & Accountability Report™

SECURITIES FRAUD

Omnicare: Negligence Is the New Strict Liability When Pleading Omissions Under the Securities Act

By Julie Goldsmith Reiser and Michael B. Eisenkraft

"Just remember, it isn't a lie if you believe it" – George Costanza

In *Omnicare Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 2015 BL 80362, U.S., No. 13-435 (Mar. 24, 2015), the U.S. Supreme Court grappled with whether to endorse views akin to Seinfeld's George Costanza: can an opinion give rise to liability if the speaker believes her statement is true? In a 7-2 decision, the Supreme Court rejected immunity for statements derived from a full heart but empty head (13 CARE 651, 3/27/15). If an investor pleads facts sufficient to show the speaker lacked a basis for her expressed belief or otherwise that she omitted contrary facts that caused investors to be misled, liability will follow. Inversely, an expressed opinion can be false without giving rise to liability so long as the speaker believed what she said, the opinion was reasonably held and contradictory facts were not concealed. In carving out an exception to a statute that holds issuers strictly liable, *Omnicare* amounts to one of the more significant Supreme Court decisions regarding the federal securities laws because it imposes a level of intent for certain statements, even though the statute has no such requirement.

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Background

The 1933 Securities Act requires a company, prior to issuing securities via a public offering, to file a registration statement, and § 11 of the Act makes statement issuers liable, via a private right of action, if, *inter alia*, that statement "contain[s] an untrue statement of a material fact" or "omit[s] to state a material fact . . . necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). Section 11 has no scienter requirement, thus the statute makes no mention of an issuer's intent to mislead.

On Oct. 4, 2013, after the U.S. Court of Appeals for the Sixth Circuit denied its motion to dismiss the plaintiffs' Securities Act claims (12 CARE 675, 6/20/14), Omnicare Inc. filed a petition for *certiorari* with the Supreme Court, presenting 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 has 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,

 ISSN 2330-6300

Third, and Ninth Circuits have held?'' The Supreme Court granted certiorari March 3, 2014 (12 CARE 1451, 11/7/14) and issued a March 24 opinion by Justice Elena Kagan that delineated the circumstances in which liability can attach to a statement of opinion in a registration statement.

Omnicare, a Fortune 500 company, represents itself as the ''market-leader in professional pharmacy, related consulting and data management services for skilled nursing, assisted living and other chronic care institutions.''[1] In December 2005, Omnicare raised approximately $750 million from investors via a public offering. In its registration statement for that public offering, Omnicare stated, ''We 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 ''[w]e believe 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.''

The plaintiffs, investors who bought securities in that public offering, alleged that at the time of the offering, Omnicare was both accepting illegal kickbacks from drug companies and paying illegal kickbacks to certain nursing homes. The Sixth Circuit found that regardless of whether the defendants believed their conduct was legal, the fact that the contracts were not lawful stated a claim under § 11 of the Securities Act. *See Ind. State Dist. Council v. Omnicare, Inc.*, 719 F.3d 498, 505 (6th Cir. 2013) (''Under § 11, however, 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.''). In other words, the Sixth Circuit held that a defendant can be held liable for any statement in a registration statement, even if couched as an opinion or belief. Omnicare disagreed, asserting that an opinion or statement of belief can generate liability *only* if the speaker did not actually believe it was true. For example, if a registration statement stated that the company ''believes that the frozen yogurt it produces is fat-free,'' under the Sixth Circuit's test, that company could be held liable if it was later found that the frozen yogurt was not, even if the company believed it was selling fat-free yogurt. According to the defendants, the company could only be liable if the yogurt was not fat-free and the company believed it was not fat-free.

Middle Ground

Taking a middle ground, the Supreme Court adopted a third approach, focusing on the distinction between affirmative misstatements and omissions. As the Supreme Court pointed out, § 11 ''creates two ways to hold issuers liable for the contents of a registration statement—one focusing on what the statement says and the other on what it leaves out.'' 2015 BL 80362, at *3. With respect to affirmative statements, the Supreme Court sided with the defendants, holding that a statement of opinion ''explicitly affirms one fact: that the speaker actually holds the stated belief'' and that ''a sincere statement of pure opinion is not an 'untrue statement of material fact,' regardless whether an investor can ultimately prove the belief wrong.'' *Id.* at *6. The Supreme Court did, however, simultaneously recognize two factual scenarios where a statement of opinion can constitute an affirmative misstatement of fact: (1) where the speaker did not actually believe what she said she believed and (2) where an embedded statement of fact within the opinion was false. *Id.* at *6–7. Using the ''believes that the frozen yogurt it produces is fat-free,'' example again, a company could be held liable under § 11 if it did not actually believe that the yogurt it manufactured was fat-free when it made that statement[2] or if some of the foundation facts embedded in the statement—for instance, that the company produces yogurt, are in fact false.

With respect to omissions, however, the Supreme Court took a much broader view of what constituted a violation of § 11 with respect to statements of belief. Specifically, the Supreme Court held that ''a reasonable investor may, depending on the circumstances, understand an opinion statement to convey facts about how the speaker has formed the opinion—or, otherwise put, about the speaker's basis for holding that view,'' but '' if the real facts are otherwise, but not provided, the opinion statement will mislead its audience.'' *Id.* at *2. Importantly, the Supreme Court held that the expectations of a reasonable investor are shaped, in large part, by the placement of the statement in a registration statement and the Supreme Court found that because ''[r]egistration statements as a class are formal documents, filed with the SEC as a legal prerequisite for selling securities to the public,'' ''[i]nvestors do not, and are right not to, expect opinions contained in those statements to reflect baseless, off-the-cuff judgments, of the kind that an individual might communicate in daily life.'' *Id.* at *9. To reuse the well-worn fat-free yogurt example, a reasonable investor would understand that the company making the fat-free yogurt claim has some scientific basis for making this claim–either based on ingredients or the result of testing the yogurt. If, in fact, the company had failed to conduct any scientific tests or inquire about the ingredients used, then its statement would be an actionable omission. In the words of the Supreme Court, the law of the land is that ''literal accuracy is not enough: An issuer must as well desist from misleading investors by saying one thing and holding back another.'' *Id.* at *10.

After Effects

How does this alter the legal landscape pre-*Omnicare*? Before the Supreme Court acted, the U.S. Courts of Appeals for the Second, Third, and Ninth Circuits had all ''held that a claim under Section 11 premised on a statement of opinion or belief requires allegations of subjective falsity.''[3]

[1] http://ir.omnicare.com/phoenix.zhtml?c=65516&p=irol-irhome (last visited Apr. 7, 2015).

[2] In a footnote the Supreme Court identified one rare exception to this situation—where the speaker believed that the statement was false, but unbeknownst to them, it was actually true. In this situation, no liability would attach under § 11 because the statement was true. *Id.* at *7.

[3] Def. Pet. at 8-9; see *Fait v. Regions Financial Corp.*, 655 F.3d 105, 110 (2d Cir. 2011) (citing *Virginia Bankshares* and holding that ''when a plaintiff asserts a claim under section 11 . . . based upon a belief or opinion alleged to have been communicated by a defendant, liability lies only to the extent that

   ISSN 2330-6300

So, on the one hand, the Supreme Court's explanation that opinions could indeed be actionable even when the party uttering them believed them to be true—if either the facts embedded in them were untrue or if the maker of the statement failed to possess a reasonable basis for making them—provides expanded protection for investors by enlarging the scope of liability. On the other hand, by the simple expedient of prefacing any statement with ''we believe'' or ''we think,'' the drafter of a registration statement can drastically reduce their exposure and transform § 11 liability—which is strict liability with no scienter requirement–into something akin to a negligence standard.

Practically speaking, we predict that this will have a significant impact on both corporate attorneys who draft registration statements and securities attorneys who litigate about them. Specifically, we expect both an increase in the use of opinion statements in registration statements—with the use of ''I think,'' ''I believe'' or other indications of uncertainty increasing exponentially, along with a more detailed description of the bases for those opinions or limitations in being able to speak with certainty. At the same time, however, we expect increasing pushback from investors who will ask, when they see the preface ''I think'' or ''I believe,'' why the company is so insecure about those statements because savvy investors will understand the new legal import of those phrases. As the Supreme Court recognized in *Omnicare*, ''[s]ellers (whether of stock or other items) have strong economic incentives to . . . well, sell (i.e., hawk or peddle)''—and this market market-based ''force[] push[es] back against any inclination to underdisclose.'' *Id.* at 11. For securities lawyers, the fights over liability will shift more to omissions that mislead rather than false statements and new battles will be fought over what defendants knew and when they knew it—a relatively new addition to Securities Act litigation given the statute's lack of a scienter requirement. Accordingly, when it comes to opinions, negligence is the new strict liability.

Tips for Practitioners

- When drafting registration statements, to convey that a statement is one of opinion, use the words ''believe'' or ''think'' and not any synonyms–the Supreme Court has accorded legal significance to those two words, as opposed to others.
- When drafting registration statements, make sure to include the basis for any statements of opinion.
- When drafting registration statements, remember that even statements of opinion must have a reasonable basis.
- For litigators on the plaintiffs' side, remember that what is not said is now perhaps even more important than what is said in a Securities Act context.
- Where investors sue under both the Securities and the Exchange Acts, *Omnicare* will have little impact because investors are already pleading scienter allegations. If statements are alleged to have been made recklessly, it follows that they also lacked a reasonable basis.

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the statement was both objectively false and disbelieved by the defendant at the time it was expressed''); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357, 368–69 (3d Cir. 1993) (''[O]pinions, predictions and other forward-looking statements are not per se inactionable under the securities laws. Rather, such statements of 'soft information' may be actionable misrepresentations if the speaker does not genuinely and reasonably believe them.''); *Rubke v. Capital Bancorp Ltd.*, 551 F.3d 1156 (9th Cir. 2009) (citing to *Virginia Bankshares* and holding that 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'').