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Supreme Court to Securities Issuers: Beware What You Omit When Stating Your Opinions

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Deciding this Term's big securities case, a unanimous Supreme Court held on March 24 that a statement of opinion does not become actionable under the "untrue statement of material fact" clause of section 11 of the Securities Act of 1933 merely because subsequent events prove it wrong, so long as the speaker honestly held the opinion. But the Court split 7-1-1 as to whether such an honest-but-wrong-in-hindsight opinion might nevertheless be actionable under the "material omissions" clause of section 11, and the Court remanded for further proceedings. Taken together, the three opinions in the case flag the issue of the extent to which opinions in a registration statement ought to be qualified and their bases explained. Omnicare, Inc. v. Laborers Dist. Council Constr. Ind. Pension Fund*, No. 13-435, 2015 WL 1291916 (Mar. 24, 2015).*

Who Should Care—and Why

The decision affects anyone contemplating a public offering, and that's a lot of companies. Initial public offerings are on the upswing (206 in 2014 versus 157 in 2013 and 93 in 2012).[1] For those who engage in public offerings, section 11 is a dangerous statute: It is a strict liability statute for the issuer[2] that does not require pleading and proving that the defendant had a culpable state of mind (unlike, say, Rule 10b-5); and it is frequently employed to attack registration statements (in 2014, 24 IPOs were challenged by securities class actions, versus 15 in 2013).[3]

[1] Cornerstone Research, *Securities Class Action Filings – 2014 Year in Review 3*, 10 (2015).

[2] Directors, officers, accountants and experts—unlike issuers—have a due diligence defense. 15 U.S.C. § 77k(b).

[3] Cornerstone Research, *supra* n.1, at 1, 8.

The *Omnicare* Case

Omnicare is the nation's largest provider of pharmacy services for nursing-home residents. Intending to make a public offering of common stock, it filed a registration statement analyzing the effect of various federal and state laws on its business model, including its acceptance of rebates from pharmaceutical companies. Two sentences in its registration statement said, "We believe our contract arrangements … and our pharmacy practices are in compliance with applicable federal and state laws" and "We believe that our contracts … are legally and economically valid arrangements …." Slip op. at 3. Accompanying these opinions were caveats, including that several states had filed enforcement actions against pharmaceutical manufacturers challenging rebates to pharmacies, that the federal government had expressed "significant concerns" about some manufacturers' rebates and that the laws might in the future be interpreted in a manner inconsistent with Omnicare's interpretation. *Id.* Plaintiff Funds bought Omnicare stock in the offering; the federal government later sued Omnicare, alleging that the rebates violated federal law.

The Funds sued Omnicare under section 11; as is typical, the complaint disclaimed any allegations of fraud or intentional or reckless misconduct.[4] The district court granted Omnicare's motion to dismiss, holding that the opinions quoted above could be actionable only if the speakers knew they were untrue when made. The Sixth Circuit reversed, holding that a section 11 complaint need only allege that the opinions were "objectively false," i.e., proved wrong by subsequent events, and it was not necessary to allege anything about the speakers' state of mind. 719 F.3d 498. Perhaps because two other circuits had reached the contrary view—that statements of opinion are actionable only if objectively and subjectively false[5]—the Supreme Court granted certiorari.

The Court's Opinion—and the Concurring Opinions

The fact clause: All nine justices agreed that an honest-but-wrong-in-hindsight opinion is not, without more, actionable under the "untrue statement of a material fact" clause of section 11. To be actionable, the opinion must be both wrong in hindsight *and* not honestly held.[6]

The omissions clause: Section 11 penalizes not only untrue statements of material fact but also omissions of material fact "necessary to make the statement therein not misleading…."[7] Because the Funds also had alleged that Omnicare's opinions omitted material facts needed to make them not misleading, the Court also considered the omissions clause.[8] And here the justices split. Justice Kagan, writing for the seven-justice majority, held that the omissions clause creates liability if a registration statement omits material facts about the statement of opinion, *and* if the omitted facts conflict with what a reasonable investor, reading the statement fairly and in context, would take from the statement itself. Slip op. at 10-19. Justice Scalia, concurring in part and in the judgment, argued that an honestly held opinion can never create section 11 liability. And Justice Thomas would have remanded without reaching the omissions issue, on the ground that it was not properly developed in the courts below.

[4] By disclaiming fraud, plaintiffs hope to avoid the pleading-with-particularity requirements of Fed. R. Civ. P. 9(b) and the Private Securities Litigation Reform Act of 1995. But this also means plaintiffs cannot claim that the opinions were not honestly held; they cannot both disclaim fraud and allege dishonesty.

[5] *Fait v. Regions Fin. Corp.,* 655 F.3d 105 (2d Cir. 2011); *Rubke v. Capitol Bancorp Ltd.,* 551 F.3d 1156 (9th Cir. 2009). Pillsbury represented the successful defendants in *Rubke*.

[6] Indeed, the Court made clear that a statement of opinion not honestly believed, but "(surprise!)" true, would not be actionable either. Slip op. at 8 n.2. If, however, the statement of opinion had embedded in it statements of fact, they might be actionable if material and wrong. *Id.* at 8-9.

[7] 15 U.S.C. § 77k(a).

[8] Plaintiffs alleged, in conclusory fashion, that Omnicare and its directors and officers lacked "reasonable grounds" for the opinions. Plaintiffs also alleged that one of Omnicare's lawyers had warned that a particular contract "'carrie[d] a heightened risk' of liability under anti-kickback laws." Slip op. at 4.

The initial commentary is all over the lot: Pundits see the decision as everything from a victory for plaintiffs to a victory for defendants to no fundamental change in the law. In our view (meaning: "this is our opinion"), there is more here for defendants than plaintiffs to like, but the Court took the middle ground and gave each side something.

To start, it was a good day for opinions generally. As the Court said, section 11's fact clause is "not, as the Court of Appeals and the Funds would have it, an invitation to Monday morning quarterback an issuer's opinions." Slip op. at 9. Affirmance of the Sixth Circuit's opinion would have turned speakers into guarantors of their predictions about the future. That didn't happen.

That much is certain. What is less certain is what guidance to take from the Court's discussion of the omissions clause. Some are taking this as a victory for the position taken by the Solicitor General: that a statement of opinion is actionable, even if honestly held, if it lacks a reasonable basis. We disagree and think the Court's opinion more nuanced than that. As we see it, the Court suggests the following analysis:

First, what would the reasonable investor read as implicit in the opinion, considering the registration statement as a whole? A reasonable investor might think it implicit that the opinion is honestly held, and has some basis or was the result of some inquiry. But a reasonable investor would not think it implicit that all facts are stated, or that no facts cut against the opinion. Slip op. at 12-13. "[A] reasonable investor generally considers the specificity of an opinion statement in making inferences about its basis." *Id.* at 13-14 n.8. And a reasonable investor also takes into account "hedges, disclaimers, and apparently conflicting information" as well as "customs and practices of the relevant industry." *Id.* at 14. "The reasonable investor understands a statement of opinion in its full context, and § 11 creates liability only for the omission of material facts that cannot be squared with such a fair reading." *Id.*

Second, considering how a reasonable investor would read the opinion, including inferences reasonably drawn (*id.* at 17), has the plaintiff alleged "particular (and material) facts going to the basis for the issuer's opinion–facts about the inquiry the issuer did or did not conduct or the knowledge it did or did not have–whose omissions makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context"? *Id.* at 18. In this regard, the Court cautioned that, on remand, "the Funds cannot proceed without identifying one or more facts left out of Omnicare's registration statement"; recitation of the statutory language will not suffice, nor will "the Funds' conclusory allegation that Omnicare lacked 'reasonable grounds for the belief' it stated respecting legal compliance." *Id.* at 19. In short, the allegedly omitted material facts must render the opinions as stated misleading by showing that the speaker "lacked the basis for making the statements that a reasonable investor would expect.…" *Id.* at 20. "That is no small task for an investor." *Id.* at 18.

What Are the Lessons of *Omnicare* for Practitioners?

Increased focus on omissions: The plaintiffs' bar is increasingly focusing on omissions rather than flat-out misstatements; *Omnicare* will accelerate that trend, as did last year's decision in *Halliburton Co. v. Erica P. John Fund, Inc.,* 134 S. Ct. 2398 (2014)[9]. It used to be that courts focused mainly on the alleged misstatements, often dispatching the alleged omissions in a sentence or two. No more.

New guidance but continued uncertainty regarding pleadings standards: Justice Kagan's opinion provides welcome guidance as to what kinds of allegations will and will not suffice. Slip op. at 11-20. Nonetheless, it will take time and further development of case law to know where courts will draw the line. For example, while not all contrary facts need be disclosed (*id.* at 13), when should one disclose contrary facts? And when not? And how does one draw that line? Time will tell.

Increased focus on state courts: The plaintiffs' bar often files section 11 cases in state court, in part to avoid what are perceived to be the higher pleading requirements in federal court. Because *Omnicare* stresses the importance of pleading facts, not conclusions (slip op. at 18, citing *Ashcroft v. Iqbal*, 556 U.S. 662 (2009)), plaintiffs may be more tempted than ever to file section 11 cases in state court—at least in states that have not adopted *Twombly/Iqbal*. Whether *Omnicare* mandates application of its pleading standard in section 11 cases brought in state court remains to be seen. Expect litigation over this.

Not a "reasonable basis" standard: Some commentators read *Omnicare* as establishing a rule that an opinion must have a reasonable basis (judged by some objective standard), or that the basis must be explained. We think those are oversimplified readings of the opinion. See discussion above of the two-part analysis suggested by the opinion.[10]

Not an impediment to motions to dismiss: We also disagree with those who suggest the opinion's analysis will make it hard to win motions to dismiss. While some defenses suggested by the Court could raise factual issues (*e.g.,* slip op. at 12 n.5), the basic task on a motion to dismiss will be to establish that a careful reading of the registration statement (part 1) negates any claim that any "particular (and material) facts" alleged by the plaintiffs have rendered what was said materially misleading (part 2).[11] These points can be argued without resort to extrinsic evidence.

Heightened focus on "hedges and disclaimers": On both the deal side and the litigation side, practitioners will want to think hard both about what is being said in the registration statement—explicitly and implicitly—and what underpins those statements. For example, a precise-sounding, quantitative opinion may require more of a basis than would something more vague. See example in slip op. at 13-14 n.8. "And to avoid exposure for omissions under § 11, an issuer need only divulge an opinion's basis, or else make clear the real tentativeness of its belief." *Id.* at 19. Therefore, in drafting the opinion, a deal lawyer might find it useful to understand the basis for the opinion, to avoid creating impressions that the basis would not support. In other words, don't overstate your degree of certitude or the diligence you did in arriving at your opinion, and note contradictory facts to the extent they are significant. Modesty about the clarity of one's crystal ball—in addition to honesty—may be the best policy.

[9] See NERA, *Recent Trends in Securities Class Action Litigation: 2014 Full-Year Review* 7 (Jan. 20, 2015) (stating that 52% of post-*Halliburton II* complaints plead *Affiliated* Ute reliance—which applies only to omissions—in addition to fraud-on-the market reliance).

[10] Reading the opinion of the Court against the Brief for the United States as *Amicus Curiae* (*see* 2014 WL 2703331), it seems clear that the Court, while finding a middle ground between the parties, did not adopt the "reasonable basis" standard suggested by the Solicitor General.

[11] The Court's focus on context here should not foreclose motions to dismiss any more than did the Court's similar focus on context in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.,* 551 U.S. 308 (2007), which has not deterred motions to dismiss challenging allegations of scienter in Rule 10b-5 cases.

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the attorneys below.

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