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CLIENT ALERT

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In *Omnicare*, Supreme Court Draws Distinction Between Factual Misstatements and Factual Omissions in Setting Standards for Determining Section 11 Opinion Statement Liability

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On March 24, the U.S. Supreme Court handed down its landmark decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*.[1] The Court vacated the U.S. Court of Appeals for the Sixth Circuit's ruling that an issuer of securities and its officers and directors could face liability under Section 11 of the Securities Act of 1933

for opinions set forth in a registration statement that later proved to be false, regardless of whether the defendants subjectively believed the opinions when the issuer filed the registration statement with the U.S. Securities and Exchange Commission (SEC). Rejecting the Sixth Circuit's objective-falsity test for determining Section 11 opinion statement liability, the Supreme Court's decision, authored by Justice Elena Kagan,[2] sets two separate standards instead: (1) a subjective-falsity standard for evaluating a plaintiff's claims that the defendants' opinions constitute untrue statements of material fact *so long as* the statements are "pure" opinions and contain no "embedded statements of [untrue] fact"; and (2) a "reasonable investor" standard for reviewing claims that the defendants' opinions omitted material facts.[3] The Court held that, to successfully allege that a pure statement of opinion is materially false, a plaintiff must plead facts showing that the defendants did not "honestly" hold the opinion stated since "a sincere statement of pure opinion is not an 'untrue statement of material fact,' regardless [of] whether an investor can ultimately prove the belief wrong."[4] To satisfy the "reasonable investor" standard with respect to an alleged omission of material fact, a plaintiff must identify "particular" material "facts about the inquiry the issuer did or did not conduct or the knowledge it did or did not have," the omission of which "makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context."[5] As the Court's decision explains, a plaintiff's burden to adequately plead the reasonable investor standard "is no small task" in that "conclusory assertions," such as "the issuer failed to reveal its basis," will not suffice.[6]

Background

Under Section 11, an investor who purchased stock in a public offering can bring a private action against the issuer of the stock (and other designated individuals) for material factual misstatements or omissions made in the registration statement. Unlike Section 10(b) of the Securities Exchange Act of 1934, Section 11 does not require that the plaintiff allege that the defendants acted with an intent to deceive or defraud investors.[7]

On December 15, 2005, Omnicare, Inc., the nation's largest provider of pharmacy services for residents of long-term care facilities, issued a public offering of common stock and, in connection with that offering, filed a registration statement with the SEC.[8] The registration statement contained, in addition to all mandated disclosures, an "analysis of the effects of various federal and state laws on [Omnicare's] business model, including its acceptance of rebates from pharmaceutical manufacturers."[9] In the following two sentences, the registration statement expressed Omnicare's view of its compliance with legal requirements:

- "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."

- "We 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."[10]

After the public offering, the federal government brought suit against Omnicare for its alleged receipt of illegal "kickbacks" from pharmaceutical drug manufacturers.[11] Citing these lawsuits, certain pension funds (Funds) that purchased Omnicare stock in the offering sued the company and its officers and directors for making allegedly "materially false" opinion statements in violation of Section 11.[12] The Funds claimed that Omnicare's officers and directors did not have "reasonable grounds" for thinking that these opinions were truthful and complete because, among other things, the company received a warning from one of its attorneys that a particular contract "'carrie[d] a heightened risk' of liability under anti-kickback laws."[13]

The U.S. District Court for the District of Kentucky granted the Omnicare defendants' motion to dismiss the Funds' complaint on the grounds that the Funds failed to allege that the defendants "knew" the opinion statements were untrue at the time they were made.[14] The Sixth Circuit reversed, holding that "the Funds had to allege only that the stated belief was 'objectively false'; they did not need to contend that anyone at Omnicare 'disbelieved [the opinion] at the time it was expressed.'"[15]

The Supreme Court's Section 11 Opinion Statement Standards

As we noted in our previous client alert (available at http://www.pepperlaw.com/publications_update.aspx?ArticleKey=3081) regarding this case, Omnicare argued in its appeal to the Supreme Court that Section 11 should be interpreted as holding defendants liable for an opinion statement *only* to the extent that the opinion was *both* objectively false (*i.e.*, the opinion turned out to be incorrect) *and* subjectively false (*i.e.*, the defendant knew it was untrue) at the time it was expressed. The Funds, on the other hand, urged the Court to adopt the Sixth Circuit's interpretation of Section 11 — that a defendant may be liable for an opinion expressed in a registration statement that turned out to be incorrect, even if the defendant believed the opinion was true at the time the statement was filed with the SEC.

In deciding what standard to adopt, the Court emphasized that "Section 11 creates two ways to hold Section 11 defendants liable for the contents of a registration statement — one focusing on what the statement says and the other on what the statement leaves out."[16] Accordingly, the Court viewed the question of what standard to adopt as presenting two "different issues," rather than one, and ultimately chose to adopt a distinct standard for each basis of Section 11 liability.[17]

When addressing the first issue, the Court pointed out that every statement of opinion "explicitly affirms one fact: that the speaker actually holds the stated belief."[18] Accordingly, a statement of "pure" opinion is only "untrue" if the speaker did not sincerely hold the opinion.[19] If, however, a statement of opinion contains supporting facts that are both material and false, then the opinion is an untrue statement of material fact.[20] Thus, "liability under [Section] 11's false-statement provision would follow . . . not only if the speaker did not hold the belief she professed but also if the supporting fact she supplied were untrue."[21] As the Court explained, this provision does not "allow investors to second-guess inherently subjective and uncertain assessments" or provide "an invitation to Monday morning quarterback an issuer's opinions."[22]

In analyzing the second issue — "when an opinion may be rendered misleading by the omission of discrete factual representations"[23] — the Court applied a "reasonable investor" standard and held that, "if a registration statement omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself, then [Section] 11's omissions clause creates liability."[24] The Court clarified, however, that the reasonable investor standard does not require a registration statement to disclose every fact that may be inconsistent with an opinion it expresses. Indeed, "[r]easonable investors understand that opinions sometimes rest on a weighing of competing facts," and "the presence of such facts is one reason why an issuer may frame a statement as an opinion, thus conveying uncertainty."[25] Moreover,

> [A]n investor reads each statement within such a document, whether of fact or of opinion, in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information. And the investor takes into account the customs and practices of the relevant industry. So an omission that renders misleading a statement of opinion when viewed in a vacuum may not do so once that statement is considered, as is appropriate, in a broader frame. The reasonable investor understands a statement of opinion in its full context, and [Section] 11 creates liability only for the omission of material facts that cannot be squared with such a fair reading.[26]

Application of the Standards to the *Omnicare* Complaint

When applying these standards to the complaint against Omnicare, the Court held that the Funds failed to state a claim of liability under Section 11's false-statement provision because (1) the Funds did not challenge the sincerity of the opinions expressed and (2) the statements at issue were pure opinion statements and contained no embedded statements of fact.[27]

As for Section 11's omissions provision, the Court remanded the case to the lower courts, since "neither court below considered the Funds' omissions theory with the right standard in mind — or indeed, even recognized the distinct statutory questions that theory raises."[28] The Court's opinion sets forth the following specific instructions for the lower courts to follow when determining whether the Funds have stated a viable Section 11 omissions claim:

- The Funds cannot proceed without identifying one or more facts left out of Omnicare's registration statement. The Funds' recitation of the statutory language — that Omnicare "omitted to state facts necessary to make the statements made not misleading" — is not sufficient; neither is the Funds' conclusory allegation that Omnicare lacked "reasonable grounds for the belief" it stated respecting legal compliance.

- The court must review the Funds' complaint to determine whether it adequately alleged that Omnicare had omitted [the purported attorney warning referenced above], or any other like it, from the registration statement. And if so, the court must determine whether the omitted fact would have been material to a reasonable investor — *i.e.*, whether "there is a substantial likelihood that a reasonable [investor] would consider it important" [under *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)].

- Assuming the Funds clear those hurdles, the court must ask whether the alleged omission rendered Omnicare's legal compliance opinions misleading in the way described earlier — *i.e.*, because the excluded fact shows that Omnicare lacked the basis for making those statements that a reasonable investor would expect. . . . Insofar as the omitted fact at issue is the attorney's warning, that inquiry entails consideration of such matters as the attorney's status and expertise and other legal information available to Omnicare at the time.

- Further, the analysis of whether Omnicare's opinion is misleading must address the statement's context. . . . That means the court must take account of whatever facts Omnicare did provide about legal compliance, as well as any other hedges, disclaimers, or qualifications it included in its registration statement. The court should consider, for example, the information Omnicare offered that States had initiated enforcement actions against drug manufacturers for giving rebates to pharmacies, that the Federal Government had expressed concerns about the practice, and that the relevant laws could "be interpreted in the future in a manner" that would harm Omnicare's business.[29]

These instructions suggest that the lower courts may have sufficient grounds to dismiss the Funds' complaint for failure to plead a violation of Section 11's prohibition against the omission of material facts in opinion statements.

Conclusion

The Supreme Court's *Omnicare* decision provides detailed guidance for courts when evaluating the sufficiency of a plaintiff's allegations of a violation of Section 11's false-statement and omissions prohibitions. It also offers the following assurance to companies disclosing opinions in registration statements: "[T]o avoid exposure for omissions under [Section] 11, an issuer need only divulge an opinion's basis, or else make clear the real tentativeness of its belief."[30] In light of this guidance, companies should carefully scrutinize and disclose the material facts that form the basis of each opinion set forth in their registration statements and consider including in that disclosure any relevant facts that might be interpreted as contradicting the opinion's basis.

Endnotes

1. *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, No. 13-435 (U.S. Mar. 24, 2015), *available at* http://www.supremecourt.gov/opinions/14pdf/13-435_8o6b.pdf.
2. Justices Antonin Scalia and Clarence Thomas filed concurring opinions.
3. *See Omnicare*, slip op. at 6–20.
4. *Id.* at 9.
5. *Id.* at 18.
6. *Id.*
7. *See id.* at 2.
8. *See Indiana State Dist. Council of Laborers & Hod Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498, 500 (6th Cir. 2013).

9. *Omnicare*, slip op. at 2.
10. *Id.* at 3.
11. *Id.*
12. *Id.*
13. *Id.* at 4 (alteration in original).
14. *Id.*
15. *Id.* (alteration in original).
16. *Id.* at 2.
17. *Id.* at 5.
18. *Id.* at 7.
19. *Id.* at 7–9.
20. *Id.* at 8–9.
21. *Id.* at 9.
22. *Id.* at 9.
23. *Id.* at 5.
24. *Id.* at 12.
25. *Id.* at 13.
26. *Id.* at 14.
27. *Id.* at 9.
28. *Id.* at 19.
29. *Id.* at 19–20.
30. *Id.* at 19.