Client Alert

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Believe It or Not? In *Omnicare*, the Supreme Court Considers the Standard of Liability for Statements of Opinion

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Americans take as given the right to hold and express opinions. So it may come as a surprise to many that the federal securities laws impose civil liability for statements of opinion. It may be even more surprising that strict liability arises for sincerely-held statements of opinion that turn out to be incorrect, at least according to the Sixth Circuit Court of Appeals in a decision that is now under review by the Supreme Court.

Yesterday, the Supreme Court heard oral arguments in *Omnicare Inc. v. The Laborers District Council Construction Industry Pension Fund*, No. 13-435, to decide the standard of liability for statements of opinion. Is it enough for a plaintiff to show that a statement of opinion was incorrect or lacked a reasonable basis? Or should a plaintiff also be required to show that the opinion was subjectively false? Liability under that standard would turn on whether the speaker sincerely believed the opinion or not.

How the Supreme Court resolves the issue is likely to shape whether, when, and how the nation's 5,200 public companies, as well as directors, officers, and other market participants, express opinions about myriad subjects, including financial and accounting judgments, appraisals of product quality, descriptions of operations, characterizations of the marketplace, evaluations of competitors, and assessments of risks and opportunities. Adoption of the Sixth Circuit standard—which conflicts with the rule adopted by every other Circuit Court of Appeals that has considered the issue—could increase the exposure of companies and other speakers to liability for inherently subjective judgments that prove incorrect, mistaken, too optimistic, or even too cautious. Given the stakes, *Omnicare* promises to be an interesting and potentially game-changing securities opinion.

THE CONTROVERSY: WHEN IS AN OPINION ACTIONABLE?

The *Omnicare* case centers on interpretation of Section 11 of the Securities Act of 1933, the statute of choice invoked by plaintiffs challenging statements contained in registration statements that are issued in connection with initial public offerings (and other registered securities offerings). The reason why plaintiffs gravitate to Section 11 when possible is that it imposes strict liability. That means plaintiffs do not need to prove a defendant's negligence, let alone intent to deceive, reliance on false statements, or proximate causation.

Liability under Section 11 is virtually absolute (subject to certain affirmative defenses) when a registration statement issued in connection with a securities offering makes "untrue statement of material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading." That formulation in Section 11 of what constitutes a false statement is nearly identical to the formulation of falsity stated in over 15 other federal securities law provisions. Given that similarity, the Supreme Court's decision in *Omnicare* could shape the standard of liability for statements of opinion under other federal securities laws as well.

What is readily apparent from reading Section 11 is that it does not expressly prohibit untrue statements of opinion. The statutory language focuses, instead, on misleading "facts." So there must be a "factual" hook to make opinions actionable, given that opinions convey subjective judgments that are not objectively verifiable. With one exception, the Circuit Courts of Appeal that have confronted this issue have concluded that statements of opinion implicitly convey one "fact" that is potentially actionable: the speaker's sincere belief in the statement. Thus liability arises only when a plaintiff can show that sincere belief in the opinion was lacking. At least that is the currently-prevailing rule that has been adopted by the First, Second, Fourth, Fifth, Ninth, and Tenth Circuit Courts of Appeals.

But that is not the case within the Sixth Circuit, where Omnicare was sued for alleged violation of Section 11. In Omnicare's registration statement and other SEC filings, Omnicare expressed its belief that its practices complied with the law. For example, Omnicare stated: "We believe that our contract arrangements with other healthcare providers, our pharmaceutical suppliers and our pharmacy practices are in compliance with applicable federal and state laws." Plaintiffs, suing on behalf of a class of purchasers of Omnicare stock, claimed that this and similar statements of belief were false or misleading because Omnicare allegedly had engaged in illegal conduct. The plaintiffs supported that allegation by pointing to allegations that were asserted in *qui tam* actions that had been filed against and settled by Omnicare, even though those actions had not resulted in any admissions or adjudications of liability.

The district court dismissed the case, finding that the complaint failed to plead that Omnicare did not believe that it was in compliance with the law. The Sixth Circuit reversed, holding that a statement of opinion is actionable when the expressed belief turns out to be objectively wrong, even if the statement was sincerely believed by the speaker at the time it was made. The Sixth Circuit acknowledged that its decision was at odds with decisions from sister Circuits. Soon thereafter, the Supreme Court granted review.

COMPETING BELIEFS ABOUT THE STANDARD OF LIABILITY

The Supreme Court is likely to choose among competing standards of liability proposed by defendants, plaintiffs, and the government, represented by the U.S. Solicitor General. Those competing positions are sketched out below.

According to Omnicare, defendants should not be liable for statements of opinion unless there is a showing of subjective falsity. In support of its argument, Omnicare draws principally on the Supreme Court's ruling in *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991). The Court in *Virginia Bankshares* considered whether a statement of opinion could ever be actionable as a misleading statement of material fact. It held that an opinion can be actionable, but only if it conveys "a misstatement of the psychological fact of the speaker's belief in what he says." In other words, the rule articulated by *Virginia Bankshares* requires a plaintiff show that a speaker did not believe his or her stated opinion. Some say that the defendant's position would encourage defendants to preface factual statements with qualifying words like "I think" or "we believe" as a means to avoid liability. Indeed, during oral argument, Chief Justice Roberts immediately seized upon that concern.

The plaintiffs, for their part, largely advocate for the rule adopted by the Sixth Circuit. At oral argument, however, there did not appear to be any support for the Sixth Circuit's position that honestly held opinions that turn out to be incorrect are actionable, without more.

A middle ground approach of sorts is offered by the government and appeared to attract support from several Justices during the argument. The government posits that a statement of opinion should be actionable if it lacked a reasonable basis under the circumstances in which it was made, even if it was sincerely held.

In support of its proposed "reasonable basis" test, the government contends that statements of opinion, at least in registration statements, implicitly convey the representation that the speaker had a reasonable basis for the opinion. Under the government's logic, it is fair to hold a speaker liable if he or she lacks a reasonable basis for an opinion yet fails to disclose the reasonable basis is lacking. Justice Kagan appeared particularly supportive of this argument and its grounding in the text of Section 11. Other justices seemed to suggest that the importance and solemnity of a registration statement might justify finding that statements of opinion are accompanied by an implied warranty that the statement is supported by a reasonable basis.

Other justices inquired about how much detail a complaint would have to plead about the lack of a reasonable basis to survive dismissal based on an apparent concern that conclusory allegations should not suffice to plead a reasonable basis was lacking. Justice Alito went further, asking for "more concrete guidance as to what is reasonable." The answer is that it will always be a "context-specific inquiry." That answer exposes the problem with a reasonable-basis test: it may not provide clarity or predictability to speakers, and could lead to subjective second-guessing by courts about whether a basis for an opinion was, in fact, reasonable.

POTENTIAL SIGNIFICANCE: WHETHER, WHEN, AND HOW TO OPINE

The Supreme Court's decision in *Omnicare* could affect both the quality and quantity of information disclosed to investors. If the Supreme Court rules that subjective falsity is not required to establish liability for opinions, there could be a dampening effect on information that companies provide to the market. After all, subjective falsity is currently required in most jurisdictions today. That change in controlling law may require corporations and those who speak on their behalf to reassess what opinions are conveyed and how they are communicated to investors.

If a subjective-falsity requirement is rejected, two equally plausible results seem possible. Either corporations would cut down on making opinions or they would change how and what opinions they give. Opinions might only follow a speaker's deliberative consultation with those in-the-know, including subject matter experts and professional advisors. Opinions might then be accompanied by an avalanche of qualifying information, including cautionary language, the specific reasons supporting a volunteered opinion, and perhaps even countervailing points. The *Omnicare* decision may thereby change the total mix of information available to investors in one way or another.

A decision in *Omnicare* is expected by the end of June, 2015.

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