BRACEWELL

INSIGHTS

Supreme Court Clarifies Standard For Holding Issuers Liable Under The Securities Act Of 1933

March 25, 2015

In a highly-watched securities law decision, the United States Supreme Court yesterday ruled unanimously that opinion statements in public securities registration statements are not actionable under § 11 of the Securities Act of 1933 if the company had a "reasonable basis" for the opinion at the time it was stated. *Omnicare v. Laborers District Counsel Construction Industry Pension Fund*, No. 13-435, 2015 WL 1291916 (U.S. Mar. 24, 2015). The Court's ruling rejects the strict liability standard advocated by plaintiffs, but also declines to create a safe harbor from securities law liability for companies providing forward-looking projections or forecasts.

The Facts

In December 2005, Omnicare filed a registration statement with the U.S. Securities and Exchange Commission in which the company stated that "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." Slip op. at 3. The company further stated that "We believe that our contracts with pharmaceutical companies are legally and economically valid arrangements . . . ." *Id.* Along with those statements, the company issued disclaimers, such as the fact that state investigators had launched investigations against certain pharmaceutical providers and that the federal government had expressed "significant concerns" about certain pharmaceutical practices. *Id.* Omnicare later sold common stock based, in part, on the December 2005 registration statement.

In February 2006, a group of pension funds that purchased common stock in Omnicare based on the December 2005 registration statement filed a class action against the company alleging that Omnicare's statement that its "contract arrangements" were in compliance with all laws was false or misleading because the company later settled a lawsuit by the government for its alleged involvement in a kickback scheme. Plaintiffs asserted claims under Section 11 of the Securities Act of 1933, which creates liability where a registration statement either (1) "contained an untrue statement of material fact," or (2) "omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). In their complaint, plaintiffs alleged that Omnicare officers and directors did not possess "reasonable grounds" for their view that the company had legal contracts with its suppliers; rather, company officials had been told by in-house counsel that their business practices "carrie[d] a heightened risk" of liability. Slip op. at 4.

The district court granted Omnicare's motion to dismiss, holding that opinion statements, like the ones made by Omnicare, are actionable only where those who made the statements knew they were untrue when they were made. *Ind. State Dist. Council of Laborers v. Omnicare, Inc.*, No. 2006-26(WOB), 2012 WL 462551, at *4 (E.D. Ky. Feb. 13, 2012). The U.S. Court of Appeals for

the Sixth Circuit reversed and held that "§ 11 is a strict liability statute" that only requires plaintiffs to plead "an untrue statement of a material fact." *Ind. State Dist. Council of Laborers v. Omnicare, Inc.*, 719 F.3d 498, 505 (6th Cir. 2013). The Court of Appeals acknowledged that it was creating a circuit split with the Second and Ninth Circuits, which have required plaintiffs to allege, and eventually demonstrate, that a material statement was both objectively false and "disbelieved by the defendant at the time it was expressed." *Id.*

The Supreme Court Weighs In

By a 9-0 vote, the Supreme Court struck a middle ground between the holdings of the Sixth Circuit on one hand and the Second and Ninth Circuits on the other. In an opinion authored by Justice Elena Kagan and joined by all Justices except Justices Antonin Scalia and Clarence Thomas, the Court concluded that material statements of opinion are actionable only if: (1) the statements are objectively false, and (2) the speaker did not actually hold the stated belief.

Separately, the Court discussed the § 11 standard for material omissions. For omissions, the Court wrote that courts should consider "whether the alleged omission rendered [the material statements] misleading," because "the excluded facts show[the issuer] lacked the basis for making those statements that a reasonable investor would expect." Slip op. at 20. In the context of Omnicare, the Court indicated a court may be required to consider whether the attorney warning Omnicare officers had the necessary status and expertise that would require officers to take notice. Material omissions must also be viewed in the context of the statements and disclaims that were, in fact, made by Omnicare. *Id.*

Justice Scalia concurred in the Court's opinion but expressed his belief that the Court's decision captures "far more expressions of opinion to convey collateral facts" than he would include. Slip op. at 1 (Scalia, J., concurring in the opinion in part and concurring in the judgment). Justice Thomas wrote separately indicating that the issue of liability for material omissions, as opposed to material statements, was not properly before the Court because it was not properly addressed by the plaintiffs or either of the courts below. Slip op. at 1 (Thomas, J., concurring in the judgment only).

Takeaway

The decision resolves a circuit split on § 11 liability and strikes a middle ground between the positions advanced by the plaintiffs and the defendants. In order to state a claim, plaintiffs will only be required to plead that material statements were false and that issuers did not have a "reasonable basis" for holding those opinions. Plaintiffs can meet this burden by pleading, with the benefit of hindsight, that a particular statement was either implausible or unlikely at the time it was made. On the other hand, defendants will not be strictly liable for any statement of opinion that later turns out to be untrue. The company will not be held liable if it can demonstrate that its officers had a "reasonable basis" for their opinions at the time the statements were made.