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Omnicare's Square Peg Problem: Importing a Section 11 Standard Into a Section 10 Framework

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The Supreme Court's 2015 decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*[1] left open a critical question that lower courts have been grappling with for the last year: does the *Omnicare* standard for determining whether statements of opinion are actionable under Section 11 of the Securities Act of 1933 apply with equal force to claims under Section 10(b) of the Exchange Act?

Omnicare held, in part, that even a sincerely held opinion can be actionable if the opinion omits material facts about the defendant's knowledge concerning the statement at issue, and if those facts conflict with a ''reasonable investor's'' reading of the statement. This omissions standard is arguably in tension with Section 10(b) of the Exchange Act of 1934 and SEC Rule 10b-5, which imposes ''a heavier burden than [ ] Section 11'' and requires proof that ''the defendant acted with scienter, *i.e.*, with intent to deceive, manipulate, or defraud.''[2]

A number of courts have nevertheless held that *Omnicare* applies to Rule 10b-5 claims, with little discussion or analysis, relying simply on symmetrical language found in in Section 11 and Rule 10b-5. Few have even noted the apparent tension between *Omnicare*'s holding that a sincerely held opinion can be actionable and Rule 10b-5's scienter requirement. In a recent decision styled *Firefighters Pension & Relief Fund of the City of New Orleans v. Bulmahn*, a federal district court in Louisiana became one of the first courts to squarely address this issue, and held that *Omnicare* does not apply to claims for securities fraud under Section 10(b). But even that court drew upon *Omnicare* for ''guidance'' in assessing the claim before it.

A closer look at *Omnicare* reveals that importing the ''omissions'' test into a Section 10(b) framework is not as simple as some courts have suggested. Applying *Omnicare* to Rule 10b-5 claims without subverting that Rule's scienter requirement requires a delicate balance that the Supreme Court—if and when it decides the issue—may find challenging.

Pre-*Omnicare* Decisions

Section 11 of the Securities Act of 1933 creates liability if any part of a registration statement ''contained an untrue statement of a material fact'' or ''omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.''[3]

Before *Omnicare*, the weight of authority held that in order for statements of opinion to be actionable under Section 11, plaintiffs must prove both objective falsity and subjective falsity—that is, not only was the speaker wrong, he or she did not sincerely hold the opinion

[1] 135 S. Ct. 1318, 1323 (2015).

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[2] *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382-83 (1983).

[3] 15 U.S.C. § 77k(a).

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when it was made. Both the Second and Ninth Circuits adopted this standard, and the Tenth Circuit indicated its agreement in dicta.[4]

The Sixth Circuit, however, took a different approach. The court adopted a sweeping view of the statute as applied to statements of opinion, holding that because Section 11 is a strict liability statute and does not require a showing of scienter, an opinion may be actionable if the statement proves false—without regard to the state of mind of the speaker.[5]

Despite this circuit split under Section 11, there was little question prior to the Supreme Court's ruling that a subjective intent element would be required under Section 10(b) and Rule 10b-5 in light of its scienter requirement. Even the Sixth Circuit, which took a more liberal approach than the other circuits and relaxed the pleading requirements under Section 11, distinguished Rule 10b-5 claims and acknowledged that such claims must be analyzed under a different—and more stringent—standard.[6]

The *Omnicare* Standard

In *Omnicare*, the Supreme Court considered whether the following statement of opinion set forth in Omnicare's registration statement was actionable under Section 11: ''*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'' (emphasis added).[7] The federal government subsequently sued Omnicare for allegedly receiving kickbacks from pharmaceutical manufacturers, and plaintiffs brought an action under Section 11 alleging that this and similar statements of opinion by Omnicare were false, on the grounds that the company was not ''in compliance'' with applicable laws.

The company argued for the approach taken by the Second and Ninth Circuits: that objective falsity is not enough, and that plaintiffs must also show that the defendant did not actually hold the stated opinion. The Supreme Court reversed the Sixth Circuit, but did not go as far as the defendants hoped.

The Court rejected the plaintiffs' argument that a statement of opinion can be actionable simply because the view expressed turns out to be wrong. At the same time, Justice Kagan, writing on behalf of seven justices, concluded that subjective falsity was not a necessary precondition for liability. Instead, the Court adopted a two-prong test. Under the first prong, a statement of opinion is false under Section 11 if the speaker does not actually hold that opinion, or if supporting facts supplied in connection with the opinion or embedded in the statement itself are untrue.[8] Because the *Omnicare* plaintiffs had not alleged that Omnicare's statements about its compliance with the law were insincere or contained untrue facts embedded within them, the Court held that the plaintiffs could not prove an actionable misstatement under Section 11.

The second prong of the test, which is most relevant here, relates to actionable omissions. The Court held that an expression of opinion may also create liability if it omits material information and would be misleading to a reasonable investor. To support a claim for an actionable omission under the *Omnicare* framework, plaintiffs ''must identify 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 omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context.''[9]

Accordingly, the Court remanded the case to the district court to consider whether the plaintiffs had adequately alleged that Omnicare omitted from its registration statement some specific fact underlying the statement of opinion that would have been material to a reasonable investor.

Post-*Omnicare* Decisions Under Section 10(b)

Omnicare did not clarify whether the omissions test is limited to claims under Section 11 or whether it applies more broadly to other federal securities laws as well. Most notably, apart from a few fleeting references discussed below, the Court did not address whether the omissions test extends to the ''judicial oak'' of Rule 10b-5, under Section 10(b) of the Exchange Act, which provides the statutory hook for many, if not most, securities fraud lawsuits.[10]

It can be argued that the first prong of the *Omnicare* test carries over into a Section 10 context, because it requires either subjective falsity or an embedded false statement of fact, both of which potentially could give rise to an inference of scienter.[11] But the omissions test, which creates liability for statements of opinion that are sincerely held but that could be misleading to a reasonable investor because of omitted information, is more difficult to reconcile with Rule 10b-5's scienter requirement.

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[4] *See Fait v. Regions Financial Corp.*, 655 F.3d 105 (2d Cir. 2011); *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1162–63 (9th Cir. 2009). These decisions were grounded, in part, on existing Supreme Court precedent that indicated that subjective falsity was required. *See Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095 (1991) (''A statement of belief may be open to objection . . . solely as a misstatement of the psychological fact of the speaker's belief in what he says.'').

[5] *Indiana State District Council of Laborers v. Omnicare*, 719 F.3d 498 (6th Cir. 2013), *vacated and remanded*, 135 S. Ct. 1318 (2015).

[6] *See id.* at 505 (''[Whereas] Section 10(b) and Rule 10b–5 require a plaintiff to prove scienter, § 11 is a strict liability statute. It makes sense that a defendant cannot be liable for a fraudulent misstatement or omission under § 10(b) and Rule 10b–5 if he did not know a statement was false at the time it was made.'').

[7] *Omnicare*, 135 S. Ct. at 1323.

[8] *Omnicare*, 135 S. Ct. at 1326-27. The Court offered as an example the statement ''I believe our TVs have the highest resolution available because we use a patented technology,'' which, while phrased as an opinion, contains an embedded statement of fact and could be actionable if the company did not actually use a patented technology. *Id.*

[9] *Id.* at 1332.

[10] *See Blue Chip Stamps v. Manor Drug Stores*, 421 U. S. 723, 737(1975) (''When we deal with private actions under Rule 10b–5, we deal with a judicial oak which has grown from little more than a legislative acorn.'').

[11] *See* Wendy Gerwick Couture, *False Statements of Belief as Securities Fraud*, 43 No. 4 Securities Regulation Law Journal Art. 2 (2016) (arguing that *Omnicare* can be applied to alleged misstatements under Section 10(b) but setting aside the ''separate question'' of ''how to analyze whether an opinion gives rise to omissions liability under § 10(b) and Rule 10b-5'').

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Yet, most courts to date have overlooked this potential tension and applied *Omnicare* to claims under Section 10(b) based on the fact that Rule 10b-5 uses certain language nearly identical to Section 11.[12] Just one week after *Omnicare* was issued, federal district courts in Massachusetts and New York applied the *Omnicare* test to claims under Rule 10b-5.[13] Neither case, however, offered any discussion of why *Omnicare* should be extended beyond Section 11. Several other district courts and one federal court of appeals followed suit shortly thereafter, applying *Omnicare* to Rule 10b-5 claims without attempting to reconcile Section 10's scienter requirement with the omissions test.[14] Most recently, the Second Circuit applied *Omnicare* to statements of opinion challenged under both the Exchange Act and the Securities Act and affirmed the dismissal of all claims without addressing this issue.[15]

One of the only courts to tackle the issue head-on to date is a federal district court in Louisiana in *Firefighters Pension & Relief Fund of the City of New Orleans v. Bulmahn*.[16] In *Firefighters Pension*, shareholders of ATP Oil & Gas Corporation (''ATP'') brought claims under Sections 10(b) and 20(a) of the Exchange Act against ATP's senior executives for alleged misstatements and omissions following the explosion of the Deepwater Horizon in the Gulf of Mexico in 2010. ATP's business involved acquiring and developing oil and natural gas properties predominantly located in the Gulf of Mexico. The business encountered a number of financial problems following the oil spill, which led to a moratorium on drilling and new regulatory requirements. Due to these regulatory challenges and certain production problems, the Company faced growing liquidity constraints and eventually declared bankruptcy in August 2012.

Many of the alleged misstatements and omissions related to statements of opinion about ATP's liquidity situation prior to the bankruptcy (calling ATP's liquidity ''strong'' and ''sound'' and predicting that ATP would be able to continue paying its debts for at least twelve months), which led the district court to consult the Supreme Court's analysis in *Omnicare*.[17] The court found that ''[i]t is not clear . . . that the Supreme Court's analysis in *Omnicare* extends to securities fraud claims under Section 10(b) of the Securities Act of 1934,'' because ''Section 11 of the 1933 Act and Section 10(b) of the 1934 Act differ in significant ways''—most notably, Section 10(b)'s scienter requirement. ''That *Omnicare* concerned a strict liability statute suggests that the Supreme Court's reasoning—which contemplates liability for statements of opinions that are genuinely held but misleading to a reasonable investor—does not directly apply to the statute at issue here.''[18]

The *Firefighters Pension* court further noted that *Omnicare* did not purport to modify the safe harbor for forward-looking statements under the Private Securities Litigation Reform Act of 1995 (''PSLRA'') and therefore would not apply to many of the defendants' statements in any event.[19] Nevertheless, with respect to opinion statements relating to present or historical fact, the court stated that it would ''use *Omnicare* as guidance and will consider the relevant principles articulated in the Supreme Court's decision.''[20]

Using *Omnicare* as guidance, the Court concluded that plaintiffs failed to provide grounds for a strong inference of scienter, and held that the defendants' opinion statements regarding ATP's liquidity did not rise to the level of actionable misstatements or omissions. Nevertheless, the Court's application of the *Omnicare* standard to opinion statements in this case continues to raise questions about the inherent tension between Rule 10b-5's scienter requirement and liability for sincerely held statements of opinion.

Can *Omnicare* Be Reconciled With Rule 10b-5's Scienter Requirement?

Firefighters Pension is unusual both in that it is one of the only cases to squarely address the issue of *Omnicare*'s reach, and in its reliance on *Omnicare* for guidance despite dismissing the case for failure to state a claim. But looking to *Omnicare* for ''guidance'' does not resolve the issue of how, if at all, the omissions test can be reconciled with Rule 10b-5's scienter requirement. As a result, while the opinion brings to the fore an important issue that other courts have not addressed, it ultimately raises more questions than it answers.

Although the Supreme Court did not decide the issue, Justice Kagan's opinion in *Omnicare* suggests that the question is more complex than the weight of authority makes it seem. Throughout the opinion, the Court made clear that it was narrowly interpreting the question presented under Section 11, which establishes '' 'a strin-

[12] Similar to Section 11, Rule 10b-5 prohibits a person from making ''an untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading[.]'' 17 C.F.R. § 240.10b–5; 15 U.S.C. § 78j.

[13] *Corban v. Sarepta Therapeutics Inc.*, No. 14-cv-10201-IT, 2015 WL 1505693 (D. Mass. 2015); *Special Situations Fund III QP, L.P. v. Deloitte Touche Tohmatsu CPA, Ltd.*, 96 F. Supp. 3d 325, 344-45 (S.D.N.Y. 2015).

[14] *See, e.g.*, *In re Genworth Fin. Inc. Sec. Litig.*, 103 F. Supp. 3d 759, 766 (E. D. Va. 2015) (''*Omnicare*'s holding is applicable and relevant to the instant case as the standard defined in Section 11 of the Securities Act is nearly identical to the [Section 10(b)/Rule 10b-5] standard at issue here.''); *In re Lehman Brothers Sec. & Erisa Litig.*, 2015 WL 5514692, at *19 n.48 (S.D.N.Y. 2015) (''The Court recognizes that *Omnicare* was a Section 11 case. Nonetheless, its reasoning applies with equal force to other provisions of the federal securities laws, including, as relevant to this case, Section 10(b) and Rule 10b–5, which uses very similar language.''); *accord In re BioScrip Stockholder Litig.*, 95 F. Supp. 3d 711, 728 (S.D.N.Y. 2015); *In re Velti PLC Sec. Litig.*, No. 13-cv-03889WHO, 2015 WL 5736589, at *33 (N.D. Cal. 2015); *City of Westland Police & Fire Ret. Sys. v. MetLife, Inc.*, No. 12-cv-00256, 2015 WL 5311196, at *1 n.3 (S.D.N.Y. Sept. 11, 2015); *Nakkhumpun v. Taylor*, 782 F.3d 1142, 1159 (10th Cir. 2015).

[15] *See In re Sanofi Sec. Litig.*, No. 15-588-cv, 2016 WL 851797, at *12 (2d Cir. Mar. 4, 2016). The *Sanofi* opinion takes a narrow view of *Omnicare*'s omissions test and confirms that ''issuers need not disclose a piece of information merely because it cuts against their projections.'' *Id.*

[16] No. 13-3935, 2015 WL 7454598 (E.D. La. Nov. 23, 2015).

[17] *Id.* at *20-25

[18] *Id.*

[19] *Id.*

[20] *Id.* The court cited *In re Merck & Co., Inc. Sec., Derivative & ERISA Litig.*, No. CIV.A 05–1151 SRC, 2015 WL 2250472, at *11 n.7 (D.N.J. May 13, 2015), which similarly concluded that ''while *Omnicare*, actually, is not directly applicable to plaintiff's Section 10(b) claims, '*Omnicare*'s analysis of its discussion of misleading opinions is, to some extent, instructive on the viability of [those] claims as to the opinion-based statements.''

gent standard of liability,' not dependent on proof of intent to defraud.''[21] In fact, the Court expressly rejected the view that ''liability for omissions under § 11 [should be limited] to cases in which a speaker 'subjectively intend[s] the deception' arising from the omission'' because ''§ 11 discards the common law's intent requirement, making omissions unlawful—regardless of the issuer's state of mind—so long as they render statements misleading.''[22] This would seem to suggest that the existence of an intent requirement—as in Rule 10b-5—counsels in favor of a heightened pleading standard not present in *Omnicare*.

The Court also observed that opinions contained in registration statements, ''which the reasonable investor expects [have] been carefully word-smithed to comply with the law,'' have stronger indicia of reliability and are viewed differently by investors than opinions offered in other contexts.[23] This comment highlights aspects of Section 11 that distinguish it from Section 10(b), and indicate, at the very least, that the issue warrants a hard look before importing *Omnicare* wholesale into the Section 10(b) context.

Notwithstanding these distinctions, if courts are inclined to extend *Omnicare* to Rule 10b-5 actions (and, as noted above, the case law is trending in that direction), it must be done in a way that does not subvert Rule 10b-5's scienter requirement. One way to potentially reconcile *Omnicare*'s omissions test with Section 10(b) would be to make clear that this test applies exclusively to the first element (whether the plaintiff has adequately alleged an actionable misstatement or omission) and that the plaintiff still must demonstrate a strong inference of scienter, separate and apart from satisfying the *Omnicare* standard. So, for example, a plaintiff would have to argue that an omission of highly material information in a statement of opinion (which undermines that statement) rises to the level of extreme recklessness sufficient to support a strong inference of scienter.

This approach is challenging for two reasons. First, it tees up an important related question that the Supreme Court has yet to decide: whether and when recklessness satisfies Rule 10b-5's scienter requirement. The circuits differ on the degree of recklessness required, and the Supreme Court has yet to decide whether *any* degree of recklessness is sufficient.[24] Whether material omissions in statements of opinion might satisfy this unsettled standard is anyone's guess. However, several circuit courts define recklessness, for purposes of establishing scienter, as involving some form of subjective intent, which is not part of the *Omnicare* framework for evaluating omissions.[25] It would seem that very few, if any, sincerely held opinions would meet this high bar. And, of course, if the Supreme Court concludes that recklessness alone is insufficient, then *Omnicare* could not be imported wholesale into the Section 10 context— because a sincerely held belief that a statement of opinion was true would be inconsistent with a finding of fraud.

Another challenge with simply adding the scienter requirement as an overlay to *Omnicare* is the fact that courts often merge the analysis of falsity and scienter. As one court explained, ''where plaintiffs allege a false statement of opinion, the falsity and scienter requirements are essentially identical because 'a material misstatement of *opinion* is by its nature a false statement, not about the objective world, but about the defendant's own belief.''[26] In fact, when turning to the issue of scienter, one court that applied *Omnicare* to a Rule 10b-5 claim stated that ''the question of scienter largely turns on the same considerations as those concerning the Defendants' statements of opinion'' and concluded that the plaintiffs had satisfied both elements where the plaintiffs had alleged that the speaker's opinions were not sincerely held.[27] But to make *Omnicare* at all workable in the 10b-5 context, it is critical that courts (and litigants) parse out the independent scienter requirement and demand a separate showing of ''intent to deceive, manipulate, or defraud.''[28]

Key Takeaways

The argument that *Omnicare* should extend beyond the borders of Section 11 appears to have found a warm reception in lower courts to date. As a result, corporations should be aware that statements of opinion in all public statements, not simply registration statements, may be subject to *Omnicare*, including its test for evaluating material omissions. Before *Omnicare*, it was widely thought that statements of opinion were insulated from liability absent a showing of subjective falsity (a fairly rigorous standard), but that is no longer the case. Now, if a statement of opinion, no matter how genuine, omits material facts and later proves false, it may subject the speaker to liability.

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[21] *Omnicare*, 135 S. Ct. at 1331 n.9.

[22] *Id.* at 1331 n.11.

[23] *Id.* at 1328; *see also id.* at 1330 (''Investors 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.''). While responses to analyst's questions on quarterly earnings calls (which often form the basis of actions under Section 10 and Rule 10b-5) cannot be fairly labeled ''baseless, off-the-cuff judgments,'' they are a far cry from carefully word-smithed registration statements, and it is not inconceivable that the Court would hold the latter to a higher standard.

[24] *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007).

[25] For example, several circuits require plaintiffs to prove that the defendant acted with a ''high degree of recklessness'' and made ''a highly unreasonable omission, involving not merely simple, or even inexcusable, negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious the actor must have been aware of it.'' *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 198 (1st Cir.1999) (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977)); *accord S. Cherry St., LLC v. Hennessee Grp. LLC*, 573 F.3d 98, 109 (2d Cir. 2009). The Ninth Circuit describes the standard differently, requiring a showing of ''either 'deliberate recklessness' or 'conscious recklessness,'. . . [involving] 'a subjective inquiry' turning on 'the defendant's actual state of mind.' '' *S.E.C. v. Platforms Wireless Intern. Corp.*, 617 F.3d 1072, 1093 (9th Cir. 2010) (citations omitted).

[26] *In re Sanofi Sec. Litig.*, 87 F. Supp. 3d 510, 534, 13–cv–8806 (PAE), 2015 WL 365702, at *18 (S.D.N.Y. Jan. 28, 2015) (citation and quotation marks omitted); *see also In re Daou Sys., Inc.*, 411 F.3d 1006, 1015 (9th Cir. 2005) (''[F]alsity and scienter in private securities fraud cases are generally strongly inferred from the same set of facts, and the two requirements may be combined into a unitary inquiry under the PSLRA.'').

[27] *In re BioScrip, Inc. Sec. Litig.*, 95 F. Supp. 3d 711, 732-33 (S.D.N.Y. 2015).

[28] *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 188 (1976).

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At the same time, there is reason to believe that even if *Omnicare* is applied to securities fraud actions under Rule 10b-5, it will not have the sweeping impact that some commentators fear. To begin with, the Supreme Court's opinion set forth several important limitations that circumscribe the scope of liability for omissions. The Court observed that an opinion statement ''is not necessarily misleading when an issuer knows, but fails to disclose, some fact cutting the other way.''[29] Whether an omission makes a statement of opinion misleading ''always depends on context,'' and, as a result, an opinion must be read ''in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information.''[30] The Court also explicitly stated that, ''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.''[31] The latter is a relatively low bar and should give some assurance to officers and directors that *Omnicare* will not open the floodgates to litigation even if the rule is extended beyond Section 11 claims.

In addition, to prove fraud, plaintiffs must still satisfy the heightened pleading standard of Federal Rule of Civil Procedure 9(b) and the PSLRA. The Court noted that this is ''no small task'' in the omissions context; plaintiffs must ''identify particular (and material) facts going to the basis for the issuer's opinion.''[32] Several courts that have applied *Omnicare* to Rule 10b-5 claims dismissed those claims due to the plaintiffs' failure to make such a showing.[33]

Moreover, many statements of opinion will be protected by the PSLRA's safe harbor for forward-looking statements. As the Court in *Firefighters Pension* noted, *Omnicare* only concerned statements of present or historical fact, and did not purport to modify the PSLRA's safe harbor for forward-looking statements. Generally, statements of opinion found in a company's disclosures involve projections about the business. As long as those statements are accompanied by meaningful cautionary language, plaintiffs must continue to prove ''actual knowledge by [the speaker] that the statement was false or misleading.''[34] These limitations will help mitigate the impact of *Omnicare* in the 10b-5 context, even if the case law continues to trend in the direction of expanding *Omnicare*'s reach.

Conclusion

If one thing is clear, it is that *Omnicare* raises a difficult and important question about the future of actionable opinion statements under Rule 10b-5, one that has not yet received significant attention from the courts. Although many courts have treated the question lightly, the *Firefighters Pension* opinion may be the first of many to take a closer look at the issue. Given the central role that Rule 10b-5 plays in securities litigation, it will not take long for the issue to percolate up to the circuit courts and perhaps, eventually, to the Supreme Court.

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[29] *Omnicare*, 135 S. Ct. at 1329.
[30] *Id.* at 1329-30.
[31] *Id.* at 1332.
[32] *Id.*
[33] *See, e.g.*, *Corban*, 2015 WL 1505693, at *11; *In re Velti PLC Sec. Litig.*, 2015 WL 5736589, at *36; *Firefighters Pension*, 2015 WL 7454598, at *30

[34] 15 U.S.C. § 78u–5(c)(1). Forward-looking statements are entitled to greater protection because they are inherently uncertain, which should be apparent to investors when deciding whether to rely upon them. The same could be said for all statements of opinion, which would counsel in favor of requiring a showing of subjective falsity in the Rule 10b-5 context.