SIXTH CIRCUIT REVIEW

Contrary to Popular Opinion: Why the Sixth Circuit's *Omnicare* Decision Should Be Reversed

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Commenting on *Indiana State District Council of Laborers v. Omnicare*, 719 F.3d 498 (6th Cir. 2013).

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I. INTRODUCTION

Indiana State District Council v. Omnicare, Inc.[1] is a case about opinions—and what it takes to hold companies liable for incorrect ones. In *Omnicare*, a three-judge panel of the Sixth Circuit held that plaintiffs need only plead objective falsity of an opinion in a registration statement to state a claim under section 11 of the Securities Act.[2] The panel's holding runs contrary to popular opinion: every other circuit court of appeals that has addressed the issue requires plaintiffs to plead both objective falsity and the defendant's subjective disbelief.[3] *Omnicare* should be reversed because it rests on deficient reasoning and will have adverse practical consequences.

II. THE SIXTH CIRCUIT'S DECISION

In connection with its December 2005 public stock offering, Omnicare submitted a registration statement to the Securities and Exchange Commission

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[1] Ind. State Dist. Council of Laborers v. Omnicare, Inc., 719 F.3d 498 (6th Cir. 2013), *cert. granted*, 82 U.S.L.W. 3242 (U.S. Mar. 3, 2014) (No. 13-435).

[2] *Id.* at 505.

[3] *See* MHC Mut. Conversion Fund, L.P. v. Sandler O'Neill & Partners, L.P., 761 F.3d 1109, 1113 (10th Cir. 2014); Fait v. Regions Fin. Corp., 655 F.3d 105, 110 (2d Cir. 2011); Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156, 1162 (9th Cir. 2009).

containing opinions about the company's legal compliance.[4] One such opinion stated, "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."[5] That opinion turned out to be incorrect, causing Omnicare to settle multiple qui tam lawsuits at a substantial financial loss to the company.[6]

In January 2006, two pension funds that had purchased stock during Omnicare's public offering filed a class action lawsuit. The amended complaint alleged that Omnicare violated section 11 of the Securities Act, which provides a cause of action for investors who acquired securities under a registration statement that "contained an untrue statement of a material fact or omitted to state a material fact."[7] According to the plaintiffs, Omnicare's legal compliance statements were untrue because, at the time they were made, the company was receiving unlawful kickbacks and submitting false claims to Medicare and Medicaid.[8] However, the plaintiffs disclaimed any allegation of fraudulent or intentional misconduct.[9] The district court dismissed the claim, holding that section 11 requires a plaintiff to plead subjective disbelief—that is, that the defendant knew its statements were untrue or misleading at the time they were made.[10]

The Sixth Circuit reversed. Judge R. Guy Cole's opinion for the panel rested primarily on the rationale that section 11 is a strict liability provision. Omnicare argued that the provision contains language materially identical to section 10(b) of the Securities Exchange Act, and because the Sixth Circuit requires plaintiffs to plead subjective disbelief under that section, the same standard should govern section 11 claims.[11] The panel disagreed, noting that section 10(b) and Rule 10b-5 require proof of scienter, whereas section 11 provides for strict liability.[12] The panel held that "once a false statement has

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[4] *Omnicare*, 719 F.3d at 500–01.

[5] Omnicare, Inc., Registration Statement (Form S-10) (Dec. 12, 2005).

[6] One of the largest settlements required Omnicare to pay $98 million for its involvement in kickback schemes. Press Release, U.S. Dep't of Justice, Nation's Largest Nursing Home Pharmacy and Drug Manufacturer to Pay $112 Million to Settle False Claims Act Cases (Nov. 3, 2009), http://www.justice.gov/opa/pr/nation-s-largest-nursing-home-pharmacy-and-drug-manufacturer-pay-112-million-settle-false [http://perma.cc/ UQX5-YPPX].

[7] 15 U.S.C. § 77k (2012).

[8] Brief for Plaintiffs at 19, *Omnicare*, 719 F.3d 498 (No. 12-5287) ("Omnicare violated the Federal Anti-Kickback Statute, assisted pharmaceutical manufacturers in promoting drugs for off-label use in violation of the Food, Drug and Cosmetic Act, assisted pharmaceutical manufacturers in evading 'Best Price' detection in violation of the Medicaid Drug Rebate Statute, and violated the federal False Claims Act.").

[9] *Id.* at 14.

[10] *See* Ind. State Dist. Council of Laborers v. Omnicare, Inc., No. 2006-26 (WOB), 2012 WL 462551, at *4–5 (E.D. Ky. Feb. 13, 2012).

[11] Brief for Defendants at 29, *Omnicare*, 719 F.3d 498 (No. 12-5287).

[12] *Omnicare*, 719 F.3d at 505.

been made, a defendant's knowledge is not relevant to a strict liability claim."[13] Consequently, the panel concluded that the district court erred in dismissing the claim.[14]

The panel also disagreed with Omnicare's contention that *Virginia Bankshares*, a Supreme Court case involving section 14(a) of the Securities Exchange Act, should be interpreted to require section 11 plaintiffs to plead subjective disbelief. The panel explained that *Virginia Bankshares* requires a plaintiff to plead objective falsity, and pleading subjective disbelief alone is not enough to state a claim under section 14(a).[15] The panel reasoned that *Virginia Bankshares* is inapplicable because the Court did not address whether plaintiffs are required to plead subjective disbelief.[16] The panel further determined that *Virginia Bankshares* has "very limited application to § 11" because the Court had assumed knowledge of falsity based on a jury verdict.[17] Thus, according to the panel, nothing in *Virginia Bankshares* alters the outcome that dismissal was improper.[18]

The *Omnicare* decision runs contrary to popular opinion. Three other circuit courts of appeals have addressed the issue, and each has held that plaintiffs must allege both objective falsity and subjective disbelief in order to survive a motion to dismiss.[19] Not surprisingly, *Omnicare* has drawn uproar from the securities defense bar. Some practitioners predict the Sixth Circuit will become the "new hotspot" for section 11 litigation,[20] while others worry the decision will chill voluntary disclosure of opinions in registration statements.[21]

After the Sixth Circuit denied rehearing en banc, Omnicare took its case to the Supreme Court. The Court granted certiorari and heard oral argument on November 3, 2014. Counsel for the plaintiffs seemed reticent to defend the reasoning of the *Omnicare* panel during oral argument,[22] and it was apparent

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[13] *Id.*

[14] *Id.* at 510.

[15] *Id.* at 506.

[16] *Id.*

[17] *Id.* at 507.

[18] *Omnicare*, 719 F.3d at 506.

[19] *See* MHC Mut. Conversion Fund, L.P. v. Sandler O'Neill & Partners, L.P., 761 F.3d 1109, 1113 (10th Cir. 2014); Fait v. Regions Fin. Corp., 655 F.3d 105, 110 (2d Cir. 2011); Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156, 1162 (9th Cir. 2009).

[20] James Grohsgal & Amy Ross, *The Sixth Circuit—The New Hotspot for Section 11 Suits*, SEC. LITIG. & REG. ENFORCEMENT BLOG (May 29, 2013), http://blogs.orrick.com/securities-litigation/2013/05/29/the-sixth-circuit-the-new-hotspot-for-section-11-suits/ [http://perma.cc/5S75-2NK4].

[21] Brian Mahoney, *Securities Defense Bar Has High Hopes Riding on Omnicare*, LAW360 (Mar. 3, 2014, 8:09 PM), http://www.law360.com/articles/514894/securities-defense-bar-has-high-hopes-riding-on-omnicare [http://perma.cc/8JB8-Z3TW].

[22] As counsel for Omnicare noted, "This is the rarer case in which none of the parties is defending the reasoning of the court of appeals below." Transcript of Oral Argument at

that certain Justices do not agree with the holding.[23] But it was also evident that some Justices are skeptical of Omnicare's proposed legal standard, which would require section 11 plaintiffs to plead both objective falsity and subjective disbelief.[24] Predictions abound as to how the case will be decided.[25]

III. WHY *OMNICARE* SHOULD BE REVERSED

The Supreme Court should reverse *Omnicare* for two reasons. First, the holding is based on the deficient rationale that section 11 is a strict liability provision. To be sure, the Court has said section 11 imposes a "stringent standard of liability," and plaintiffs "need only show a material misstatement or omission to establish [a] prima facie case."[26] This makes sense for statements of *fact* (e.g., historical data) because objective falsity can be determined at the time the statements were made. However, strict liability does not make sense for statements of *opinion* (e.g., legal compliance) because unlike a fact, an opinion is only untrue if the speaker does not actually believe it or if it lacks a reasonable basis.[27] Given the difference between facts and opinions, it is inappropriate to treat them similarly for purposes of section 11 liability.

Furthermore, the *Omnicare* panel's reasoning overlooks an important aspect of section 11. The prohibition on material misstatements and omissions applies to "any part of the registration statement, *when such part became effective*."[28] In other words, whether a statement is untrue or misleading is determined at the time the statement was made. Yet the panel's holding allows investors to sue any time the subject matter of an opinion is determined to be objectively incorrect, regardless of whether the opinion was sincerely held or

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54, Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 82 U.S.L.W. 3242 (argued Nov. 3, 2014) (No. 13-435).

[23] For example, Justice Breyer believes the proper pleading standard should consider whether there was a reasonable basis as well as the issuer's state of mind. *Id.* at 27–28.

[24] Chief Justice Roberts appeared to be among the skeptics, as he suggested that Omnicare's proposed standard would insulate companies from liability as long as they preface statements with the words "we believe." *Id.* at 4.

[25] *See, e.g.*, Richard Booth, *Argument Analysis: Justices Seem Likely to Affirm* Omnicare, SCOTUSBLOG (Nov. 4, 2014, 12:35 PM), http://www.scotusblog.com/2014/11/argument-analysis-justices-seem-likely-to-affirm-omnicare/ [http://perma.cc/HR9V-ZWQH] ("Following yesterday's oral argument, there is not much doubt that the Supreme Court is inclined to affirm the decision of the Sixth Circuit . . . ."); Lawrence Hurley, *To Tell the Truth: U.S. Top Court Mulls* Omnicare *Securities Case*, REUTERS (Nov. 3, 2014, 3:13 PM), http://www.reuters.com/article/2014/11/03/usa-court-omnicare-idUSL1N0ST0SC20141103 [http://perma.cc/UB6E-RX2N] ("Judging from questions posed during an hour of oral arguments, the most likely outcome is that the nine justices will throw out the appeals court decision.").

[26] Herman & MacLean v. Huddleston, 459 U.S. 375, 381–82 (1983).

[27] Brief for U.S. as Amicus Curiae in Support of Vacatur and Remand at 11, *Omnicare*, 82 U.S.L.W. 3242 (U.S. June 12, 2014) (No. 13-435).

[28] 15 U.S.C. § 77k (2012) (emphasis added).

reasonably based at the time it was stated. Under this approach, liability for mistaken opinions would often be contingent on future events that may be unknowable to the issuer.[29] Permitting liability by hindsight does not comport with the plain language of section 11.

The second reason *Omnicare* should be reversed is because of its negative practical consequences. Lowering the bar for plaintiffs by allowing them to plead objective falsity alone exposes companies to expansive liability. Increased risk of liability means higher costs of doing business for companies, and these costs are passed along to the public.[30] Moreover, as Justice Sotomayor observed during oral argument, relying on evidence of what happened later rather than at the time the opinion was stated means "never hav[ing] closure on a securities action,"[31] which further raises costs to companies. Increased cost and risk of liability may discourage companies from participating in public stock offerings altogether.[32]

Investors will also suffer adverse consequences because of *Omnicare*. Investors benefit from having access to information that companies voluntarily disclose.[33] But holding companies liable whenever their opinions turn out to be incorrect will have a chilling effect on voluntary disclosure in registration statements.[34] Less disclosure deprives investors of information that may inform their decisions to purchase securities, and it exacerbates the information asymmetry between investors and companies.[35] Additionally, lowering the bar for section 11 pleading could produce an uptick in shareholder litigation, which has decreased stock value in the past.[36] Thus, making it easier for investors to sue companies for mistaken opinions harms shareholders and companies alike.

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[29] Brief for Petitioners at 34, *Omnicare*, 82 U.S.L.W. 3242 (U.S. June 5, 2014) (No. 13-435). Legal compliance opinions are especially vulnerable to hindsight liability because the law changes rapidly in highly regulated industries such as health care, making it difficult for companies to predict how a court will rule. *Id.* at 35.

[30] SEC v. Tambone, 597 F.3d 436, 453 (1st Cir. 2010) (Boudin, J., concurring).

[31] Transcript of Oral Argument, *supra* note 22, at 29.

[32] Brief for Chamber of Commerce of U.S. and Business Roundtable as Amici Curiae Supporting Petitioners at 21–24, *Omnicare*, 82 U.S.L.W. 3242 (U.S. June 12, 2014) (No. 13-435).

[33] *See* Susan B. Heyman, *The Quiet Period in a Noisy World: Rethinking Securities Regulation and Corporate Free Speech*, 74 OHIO ST. L.J. 189, 207–09 (2013); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1278 (1999).

[34] Brief for Petitioners, *supra* note 29, at 36–37.

[35] *See* Elizabeth Pollman, *Information Issues on Wall Street 2.0*, 161 U. PA. L. REV. 179, 207–08 (2012).

[36] MUKESH BAJAJ ET AL., U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, ECONOMIC CONSEQUENCES: THE REAL COSTS OF U.S. SECURITIES CLASS ACTION LITIGATION at 35 (Feb. 28, 2014), http://ssrn.com/abstract=2404001 [http://perma.cc/2NMT-RXX4].

IV. CONCLUSION

Companies should not be able to escape section 11 liability simply by framing a factual statement as an opinion—but they should not be liable when good faith opinions turn out to be incorrect. The Sixth Circuit's *Omnicare* decision rests on deficient reasoning because it fails to account for differences between facts and opinions. It is also inconsistent with the plain language of section 11, which provides that objective falsity is determined at the time the registration statement became effective. The decision will have adverse consequences for companies by expanding liability, increasing costs, and discouraging public offerings. It will also negatively affect investors by chilling the disclosure of opinions and lowering stock value. For these reasons, *Omnicare* should be reversed.