

SIXTH CIRCUIT REVIEW

**The Sixth Circuit's
In re Omnicare, Inc. Securities Litigation Holding:
New Standard. New Results?**

W. HUNTER WEST*

Commenting on *In re Omnicare, Inc. Securities Litigation*, 769 F.3d 455 (6th Cir. 2014).

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I. INTRODUCTION

On October 10, 2014, the Sixth Circuit established a new standard plaintiffs must meet to satisfy the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 (PSLRA).¹ With this new standard, the court reentered the battleground of securities fraud actions arising out of § 10(b) of the Securities Exchange Act of 1934 (1934 Act) and Securities and Exchange Commission (SEC) Rule 10b-5.² In *KBC Asset Management N.V. v. Omnicare, Inc.* (*In re Omnicare, Inc. Securities Litigation*),³ the court attempted to clarify the complex relationship between the PSLRA and § 10(b) actions, creating a new standard for successfully pleading securities fraud. Under the new standard, courts must first analyze whether there is a material misrepresentation or omission objectively, then determine corporate scienter by taking into account the state of mind of some, but not all, corporate employees.⁴ While this new standard does help clarify

*J.D. Candidate, The Ohio State University Moritz College of Law, expected 2015; B.A., The Ohio State University. Thanks to Jackson Froliklong, Ryan Harmanis, Jared Hasson, Professor G. Paul Rose, and Jordan Watrous for their incredibly helpful comments on this piece.

¹ 15 U.S.C. § 78u-4 (2012).

² See 15 U.S.C. §§ 78j(b), 78t(a) (2012); 17 C.F.R. pt. 240 (2014).

³ *KBC Asset Mgmt. N.V. v. Omnicare, Inc.* (*In re Omnicare, Inc. Sec. Litig.*), 769 F.3d 455 (6th Cir. 2014).

⁴ See *id.* at 470-75.

the pleading requirements of a § 10(b) action, it is doubtful that the court's decision will meaningfully change the results of such disputes.

II. IN RE OMNICARE, INC. SECURITIES LITIGATION

On December 1, 2008, John Stone, then Omnicare's Vice President of Internal Audit, was discharged from his employment by the company.⁵ In the wake of his firing, he filed a False Claims Act *qui tam*⁶ action against Omnicare alleging fraud and improper termination.⁷ The allegations centered on a series of audits conducted internally by Omnicare that professed to show noncompliance with Medicare and Medicaid requirements and pervasive fraud at the audited Omnicare facilities.⁸ Stone alleged that he was terminated for presenting the results of the final "Pharmacy Audit" to the Omnicare president at the time, Joel Gemunder.⁹

On May 11, 2012, after the audits and *qui tam* action became public, KBC Asset Management N.V. (KBC) filed a class action suit on behalf of several Omnicare shareholders.¹⁰ KBC claimed that Omnicare and several of its officers committed securities fraud in violation of § 10(b) of the 1934 Act. The plaintiffs alleged that the audits, along with other evidence, showed Omnicare materially misrepresented or omitted information about the company's compliance with Medicare and Medicaid regulations in public statements and SEC filings.¹¹ These statements, which include statements by Gemunder and statements on SEC Form 10-K filings, were qualified and were not made in hard, definitive terms.¹² For example, the 10-K filing in question stated that "[Omnicare] believe[s] that [its] billing practices materially comply with applicable state and federal requirements."¹³ Omnicare moved to dismiss for failure to state a claim and the district court granted the motion, finding that the plaintiffs had failed to plead sufficient facts with enough particularity to satisfy the heightened PSLRA standards.¹⁴

Securities fraud under § 10(b) of the 1934 Act and SEC Rule 10b-5 has six elements: "(1) a material misrepresentation or omission by the defendant"

⁵ *Id.* at 463.

⁶ In a *qui tam* action, a private party brings a suit on behalf of the government to "recover a remedy for a harm done to the government." 36 AM. JUR. 2D *Forfeitures and Penalties* § 83 (2014). In this case, Mr. Stone "filed a twenty-four-count *qui tam* action against Omnicare under the False Claims Act, alleging that the company committed various kinds of fraud and improperly terminated his employment." *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 463.

⁷ *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 463.

⁸ *Id.* at 462–63.

⁹ *Id.* at 463.

¹⁰ *Id.* at 460, 463.

¹¹ *Id.* at 461.

¹² *Id.* at 464.

¹³ *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 464 (emphasis added).

¹⁴ *Id.* at 465.

(Element One); “(2) scienter” (Element Two); “(3) a connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misrepresentation or omission; (5) economic loss; and (6) loss causation.”¹⁵ The parties only disputed Element One and Element Two on appeal, and the court analyzed both at length.

Element One, the “material misrepresentation or omission” element, is actually three separate inquiries. First, the court must determine if the statement is material—meaning that a reasonable shareholder would consider the information important in deciding how to vote.¹⁶ Second, the court must separate misrepresentations and omissions and analyze each under different standards.¹⁷ Third, the court must distinguish objectively verifiable information from soft, opinion-type information and apply different tests to these as well.¹⁸

Successfully pleading Element Two, the scienter element, in securities fraud cases is also difficult because plaintiffs must plead this element with particularity to satisfy the heightened PLSRA requirement.¹⁹ This inquiry becomes even more complex if the corporate entity itself is a defendant because the court must determine whose knowledge matters for the purposes establishing sufficient scienter.²⁰ Ultimately, the Sixth Circuit formulated a novel standard for determining scienter in securities fraud cases that represents the middle ground between existing circuit court tests.²¹ Under this new formulation, the court affirmed the district court’s decision to dismiss the

¹⁵ *Id.* at 469 (citation omitted).

¹⁶ *See id.* at 470–72.

¹⁷ *See id.* at 470–72.

¹⁸ *Id.* at 470. These three inquiries will be explored further in Part III. *See infra* Part III.

¹⁹ *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 473. The Supreme Court of the United States interpreted this PLSRA language in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, and created a three-part test for courts to apply when assessing the scienter element. 551 U.S. 308, 322–23 (2007). Courts assessing a plaintiff’s scienter allegations in securities fraud cases must (1) “accept all factual allegations in the complaint as true[;]” (2) “consider the complaint in its entirety and decide whether *all* of the facts alleged, taken collectively, give rise to a strong inference of scienter;” and (3) “assuming that plaintiff’s allegations create a powerful or cogent inference of scienter . . . a court must compare this inference with other competing possibilities, allowing the complaint to go forward only if a reasonable person would deem the inference of scienter cogent and at least compelling as any opposing inference one could draw from the facts alleged.” *See In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 473 (quoting *Tellabs, Inc.*, 551 U.S. at 322–23) (internal quotation marks omitted).

²⁰ *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 474.

²¹ *See id.* at 474–75. The Fifth and Eleventh Circuits will only allow scienter to be imputed to corporations under the theory of *respondeat superior*, and do not consider any collective corporate scienter. *Id.* at 473–74. Therefore, these two circuits represent the most corporation-friendly circuits while other courts, such as the Second, Seventh, and Ninth Circuits, do allow at least some determination of collective corporate scienter outside of looking specifically at the mindset of the officers who made the allegedly misleading statements. *Id.* at 474–75 (citations omitted).

plaintiff's claims against both the individual defendants and Omnicare as a corporation.²²

III. THE NEW STANDARD

In affirming the district court, the Sixth Circuit took the opportunity to clarify a small pleadings portion within the complex world of securities fraud litigation. Under the new Sixth Circuit standard, courts must analyze Element One—that the defendant made a material misrepresentation or omission—objectively.²³ This is an important clarification because, previously, if a court analyzed a soft information misrepresentation, the court often conflated this analysis with Element Two.²⁴ Initially, a plaintiff must now plead facts sufficient to show that the information in question was material, meaning that the information “would change an investor's mind about whether to buy or sell stock.”²⁵ Then, if the plaintiff alleges a misrepresentation, the plaintiff must show that the information is objectively false or misleading in light of what is known at the time of the suit.²⁶ If the plaintiff alleges an omission, the plaintiff must plead facts sufficient to show that the omission occurred where the corporation had a duty to disclose.²⁷ The court noted that if a reasonable jury could find the information in a corporate statement to be objectively false, that same jury could find that a duty to disclose existed, satisfying the requirements of an omission under Element One.²⁸

If the plaintiff survives Element One with respect to either a misrepresentation or omission, pleading Element Two under the new standard remains a difficult, subjective inquiry. For cases with corporate defendants, the Sixth Circuit sought to find a balance between plaintiffs abusing loose interpretations of a previous Sixth Circuit decision²⁹ and corporations avoiding liability for defrauding the public through “tacit encouragement and willful ignorance.”³⁰ Under the new standard, the state of mind of all the following are probative to the court when determining if the plaintiff established that the corporate defendant knew the statement was false or misleading: (1) the individual who made the statement in question; (2) any agent of the

²² *Id.* at 484.

²³ *Id.* at 470.

²⁴ *See id.*

²⁵ *See id.* at 478.

²⁶ *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 470.

²⁷ *See id.* at 479–80.

²⁸ *See id.* at 480–81.

²⁹ *City of Monroe Emps. Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651 (6th Cir. 2005). The court in *City of Monroe* allowed plaintiffs to impute knowledge of a corporate officer to the corporation when the officer was not even involved in making the statement. *See In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 474. Here, the court was concerned that the *City of Monroe* decision “could expose corporations to liability far beyond what Congress has authorized.” *Id.* at 475.

³⁰ *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 477.

corporation who prepared, reviewed, approved, or even furnished information for the statement; and (3) any director or high-level manager who approved, recklessly disregarded, or tolerated the misrepresentation after its issuance.³¹ This formulation goes beyond the narrow *respondeat superior* interpretation of the Fifth and Eleventh Circuits,³² but stops short of allowing consideration of the mindsets of employees who were not connected to the statement.

Here, although the Sixth Circuit reached the same ultimate decision as the district court, the courts disagreed in several important respects. Most notably, the Sixth Circuit held that the plaintiffs *had*, in fact, satisfied their pleadings burden with respect to Element One of the § 10(b) test.³³ So while the plaintiffs failed before the district court even reached further elements of the § 10(b) test, the Sixth Circuit's new objective analysis of the existence of a material misrepresentation or omission allowed the plaintiffs to proceed to Element Two.

IV. NEW RESULTS?

The Sixth Circuit's new standard appears to be a sensible middle ground. Will this new standard, however, really impact the results of securities fraud cases? Will more cases proceed past the motion to dismiss stage because judges must now consider the mindset of lower level employees who were indirectly involved in the creation of public statements? The answers to these complicated questions lie in how future courts apply this test.

While the Sixth Circuit's new formulation allowed the *KBC* plaintiffs to proceed to the scienter requirement, this may well be a hollow victory for future plaintiffs because the plaintiffs here still failed to satisfy Element Two of the test. This raises the question of whether the new standard actually improves the lot of plaintiffs or just defers their ultimate failure until later in a court's opinion. In soft information cases involving vague opinion statements there remains a high bar for plaintiffs to plead sufficient facts to show that individual defendants had actual knowledge of the statement's falsity. Even where the court now allows an individual employee's knowledge to be imputed to the corporation, it may not be sufficient to establish a strong inference that the defendant acted to defraud the public.³⁴

So while the Sixth Circuit's new standard embraces a reasonable middle ground and helps to clarify the first two elements of the § 10(b) test, plaintiffs still face the same obstacles of pleading fraud with sufficient particularity to

³¹ *Id.* at 476.

³² *See* *Southland Sec. Corp. v. INSpire Ins. Solutions, Inc.*, 365 F.3d 353, 366 (5th Cir. 2004); *see also* *Phillips v. Scientific-Atlanta, Inc.*, 374 F.3d 1015, 1018–19 (11th Cir. 2004). These courts look only to the state of mind of the individual corporate officials or employees who have a hand in creating the statement, rather than to the collective knowledge of all employees. *See id.*

³³ *In re Omnicare, Inc. Sec. Litig.*, 769 F.3d at 481.

³⁴ *See id.* at 484.

satisfy the PLSRA. This may help future courts more accurately apply the correct set of pleadings requirements for § 10(b) actions without much effect on a plaintiff's chances of advancing the litigation.

V. CONCLUSION

Attaining clarity in securities fraud cases can seem, at times, like a Sisyphean task. The overlapping standards and distinctions, the prevalence of necessarily subjective analyses, and the impact of the PLSRA result in a complicated landscape. In *In re Omnicare, Inc. Securities Litigation*, the Sixth Circuit does an admirable job of succinctly and effectively walking through a motion to dismiss inquiry for a § 10(b) action. The case establishes a standard for corporate scienter that gives courts the flexibility necessary to deliver justice in these cases while balancing the relevant concerns. It seems doubtful, however, that this standard results in a more favorable environment for plaintiffs in § 10(b) actions. Plaintiffs will likely continue to face the same challenges in surmounting heightened pleadings requirements, resulting in little effect on the ultimate disposition of cases.