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Supreme Court Guidance on Opinions in Registration Statements

From the Experts

Robert A. Horowitz, Steven M. Malina and Brian D. Straw

Faced with the new test enunciated by the U.S. Supreme Court this year in Omnicare v. Laborers District Council Construction Industry Pension Fund, corporate securities lawyers will have to make extremely difficult and subjective decisions when it comes to advising their clients whether to disclose opinions in registration statements and, if so, whether the opinions might be considered materially misleading if not accompanied by disclosure of facts that might contradict the opinion.

The case arose out of a registration statement Omnicare filed in connection with its 2005 stock offering. Two sentences expressed the company's opinion concerning its compliance with the law:

- "We believe our contract arrangements with other health care providers, our pharmaceutical suppliers and our pharmacy practice are in compliance with applicable federal and state laws."
- "We believe that our contracts with pharmaceutical manufacturers are legally and economically valid arrangements that bring value to the health care system and the patients that we serve."

The company's opinion turned out to be wrong. Several years after Omnicare filed the registration statement, the federal government commenced a civil False Claims Act suit alleging that its receipt of payments from drug manufacturers violated anti-kickback laws. Citing these suits, certain pension funds that purchased stock in Omnicare's public offering sued the company and certain directors and officers under Section 11, alleging that the company's statement of opinion about its legal compliance was false and misleading.

The district court granted Omnicare's motion to dismiss, holding that a statement of opinion is not actionable unless it was "subjectively false," i.e., the speaker did not honestly hold the opinion at the time. The U.S. Court of Appeals for the Sixth Circuit reversed, holding it sufficient for the pension funds to allege that the stated belief was "objectively false" as evidenced by the fact that it turned out to be false, regardless of whether the funds alleged that anyone at Omnicare disbelieved the opinion. The Supreme Court granted Omnicare's writ of certiorari to consider when statements of opinion are actionable under Section 11 of the Act.

The Court disagreed with both the district court and the Sixth Circuit. It announced a new test for determining whether a statement of opinion in a registration statement may give rise to liability for a material omission:

"[I]f a registration statement omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself, the § 11's omissions clause creates liability."

The Court stressed that a statement of opinion is not necessarily misleading merely because the issuer is aware of particular facts that cut against the

opinion. Only if the withheld facts would lead a reasonable investor to disregard the stated opinion would the issuer be liable for failing to disclose those facts.

The Court then went on to discuss the plaintiff's burden to plead a Section 11 violation based upon a statement of opinion that omits to state material facts that cut against the opinion:

"The investor 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. . . That is no small task for an investor."

The difficulty in applying the Supreme Court's test is exemplified by the Omnicare facts with which the district court will have to deal on remand. Omnicare's opinions that it was in compliance with applicable federal and state law were accompanied by caveats. Omnicare cited several state-initiated enforcement actions against pharmaceutical manufacturers for offering payments to pharmacies that dispensed their products, and then cautioned that future interpretation and application of the laws relating to such rebates might be inconsistent with its current interpretation. Omnicare also noted that the federal government had expressed "significant concerns" about some manufacturers' rebates to pharmacies. However, Omnicare failed to disclose that an attorney warned that one of Omnicare's contracts presented a "heightened risk of legal exposure" under anti-kickback rules.

Faced with the warning, what should Omnicare have done? Expressed its opinion as it did without any reference to the warning? Expressed its opinion, but disclosed the attorney's warning as a third caveat? Refrained from expressing its opinion?

In light of the new test, if a company chooses to express an opinion in a registration statement, its corporate securities attorney must inquire as to the basis for the opinion and all facts that might undermine the opinion in any way, and then advise the company whether a reasonable investor might consider those facts to be material. How will that play out in practice?

After Omnicare, is the corporate securities lawyer supposed to advise his client that any time an attorney raises an issue that creates doubt as to the opinion expressed, the company must disclose the otherwise privileged communication? The Supreme Court addressed an easy example: the fact that an issuer did not disclose that a single junior attorney expressed doubts about a practice's legality when six of his more senior colleagues gave a stamp of approval would not make the opinion that the issuer is in legal compliance misleading.

But what if the attorney who expressed doubts about a practice's legality is outside counsel who specializes in the compliance issue at hand, but in-house counsel and the business folks conclude the practice is legal? Is the fact that outside counsel raised an issue a material fact that must be disclosed? If so, what would the disclosure look like? Perhaps: "We believe we are in compliance with federal and state regulations. Our outside counsel raised an issue concerning our compliance and we considered the concern he raised, but we continue to believe we are in compliance." Even if such a disclosure were otherwise realistic, disclosure of otherwise privileged communications is fraught with obvious dangers.

For those issuers concluding from this uncertainty that the better course might be not to consult an attorney before expressing the opinion, the Supreme Court anticipated that conclusion and knocked it down. The Court noted an issuer that states it believes its conduct is lawful without disclosing it did not consult counsel would be making a misleading statement actionable under Section 11. As Omnicare argued to the Supreme Court, the new test might simply cause companies not to express opinions in their registration statements.

While issuers can breathe a sigh of relief as a result of the Court's rejection of the Sixth Circuit's view that issuers can be held liable under Section 11 for sincerely held opinions that turn out to be false, the Supreme Court's decision creates enormous uncertainties as to when an issuer can safely state an opinion and what facts it would need to disclose to protect itself from Section 11 claims should its opinions prove to be false.

Fortunately, the Court made clear that reasonable investors should not expect every fact known to an issuer to support its opinions, and that such statements should be read in light of all its surrounding text, including hedges and disclaimers. Nevertheless, the prudent course for an issuer may be to refrain from offering any opinions, a result that would not be welcomed by investors and is not necessarily consistent with the disclosure-based regulatory regime underlying the '33 Act.

Robert A. Horowitz is co-chair of the securities litigation practice and a shareholder in the financial and regulatory compliance practice at Greenberg Traurig. Steven M. Malina is a shareholder in the securities litigation practice and financial services litigation practice at the firm. Brian D. Straw is an associate in the litigation practice at the firm.