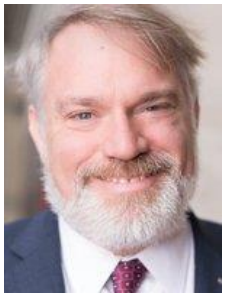
2nd Circ. Gives Teeth To Omnicare Securities Fraud Standard

By Chris Provenzano (October 21, 2020)



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Securities claims under Securities Exchange Act Rule 10b-5 rise or fall based on the allegedly false factual statements.

At the pleading stage, success often depends on how these statements end up being characterized. If the defendants can persuade the court that the allegedly false statements are statements of opinion rather than statements of fact, the plaintiffs are usually out of luck. After all, how can an opinion be a fact, much less false?

This summer, the U.S. Court of Appeals for the Second Circuit told us how in Abramson v. NewLink Genetics Corp. Abramson explains that when a defendant has expressed an opinion, it was, at least in theory, presumably based on facts, and a buyer or seller of securities can rely on the facts implied by, but omitted from, the statement.

This holding potentially opens up new avenues for securities plaintiffs under Rule 10b-5, and suggests that securities issuers — whether of public or exempt securities — should exercise more caution than formerly when expressing opinions.

In Abramson, the Second Circuit looked back at a U.S. Supreme Court case from 2015: Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund. Omnicare considered liability for statements of opinion under the Securities Act rather than the Securities Exchange Act and Rule 10b-5.

To understand Abramson and its significance, you need to understand the fact and opinion framework laid out in Omnicare.

For plaintiffs, there had historically been one way to avoid having opinion claims dismissed: showing that the opinion was deceptive because it was not sincerely held. For example, if a CEO publicly expresses boundless optimism for the company — "We're poised for fantastic success" — but privately admits to confidants that the company's stock is a dog — "Boy are we in trouble" — the CEO's stated, but personally disbelieved, opinion can potentially support a claim for fraud.

Purchasers of the stock were presumably entitled to rely on the fact that the CEO's enthusiasm was, even if boneheaded, at least genuine. But from a plaintiff's pre-discovery perspective, this is a difficult allegation to make in good faith, and smart corporate executives know better than to put "our stock is a dog" in writing.

In Omnicare, the Supreme Court confirmed that the insincerity of an opinion could support liability under Section 11 of the Securities Act.

But the Omnicare court went further, in a way that suggested a new avenue of attack for plaintiffs. The court reasoned that, statements of opinion reasonably imply that the speaker has at least made an inquiry into the facts, and that the opinion is at least somewhat consistent with those unstated facts:

> [A] reasonable investor may, depending on the circumstances, understand an opinion statement to convey facts about how the speaker has formed the opinion — or, otherwise put, about the speaker's basis for holding that view. And if the real facts are otherwise, but not provided, the opinion statement will mislead its audience.

In the example the court gave, the statement "we believe our conduct is lawful" suggests that there has been some meaningful legal analysis, and that the opinion fairly aligns with the results of that analysis. If there has been no inquiry, or if there has been an inquiry and the advice of counsel was to the contrary, sticking "it is my opinion" in front of the statement would not insulate the speaker from liability.

The similarity between Section 11 of the Securities Act and Rule 10b-5 of the Exchange Act immediately raised the question of whether Omnicare could be used to support 10b-5 claims based on statements of opinion.

It certainly seemed reasonable to conclude that it gave the "omissions" prong of 10b-5 new force by applying it in the context of opinion statements: If an opinion fairly implies certain facts, omitting material facts that would call that opinion into question could form the basis for liability and could be actionable.

Indeed, the Second Circuit had occasion to examine Omnicare in the 10b-5 context shortly after it was decided, in Tongue v. Sanofi Pharmaceuticals Inc. in 2016. However, in Tongue, the court concluded that Omnicare could not rescue the opinion statements at issue given their nature and context. Tongue therefore provided little meaningful guidance.

This summer's Abramson decision, however, definitely gave Omnicare more bite.

Abramson involved claims under 10b-5 for statements by a pharmaceutical company about a developmental drug. The U.S. District Court for the Southern District of New York dismissed claims based on language that it concluded was puffery. It also dismissed claims based on optimistic statements about the results of clinical trials that it characterized as opinion.

The Second Circuit concluded that the trial court correctly dismissed the puffery claims. However, the Second Circuit applied Omnicare to save the claims that the trial court had concluded were based on non-actionable opinion. The court noted that, previously:

> [A] district court's characterization of a statement as one of opinion rather than one of fact was all but fatal to the plaintiff's Rule 10b-5 claim. Plaintiffs challenging a statement of opinion had to plead "that the statement was both objectively false and disbelieved by the defendant at the time it was expressed."

The court concluded, however, that Omnicare had eroded the formerly critical distinction between statements of fact and of opinion, and that plaintiffs can support fraud claims by "alleg[ing] that a statement of opinion, without providing critical context, implied facts that can be proven false." This meant that the Second Circuit:

> [N]eed not decide whether the district court's classification and methodology for winnowing statements of fact from those of opinion ran afoul of Omnicare. By increasing the ability of plaintiffs to plead material omissions with respect to statements of opinion … Omnicare reduced the significance of district courts' classification of statements as those of fact or opinion.

As a result, the plaintiffs would have an opportunity to prove their case and the defendants, win or lose, would have to undergo the substantial cost and inconvenience of discovery.

Curiously, the Abramson panel did not reference the Second Circuit's earlier decision in Tongue v. Sanofi. Although the two can be read consistently, the Abramson decision lays out a more plaintiff-friendly approach with a more robust reading of the pleading opportunity provided by Omnicare.

Lessons for Plaintiffs

For 10b-5 plaintiffs, the Abramson decision potentially puts teeth in Omnicare. Abramson tells district courts they should no longer carefully parse every allegedly false statement in a complaint and place it in a fact bucket or an opinion bucket. However, the puffery bucket appears to be intact, and a good place for defendants to have the court stick their statements.

Plaintiffs can now look with somewhat more optimism at press releases, investor calls and interviews with senior executives and find a place for statements prefaced by "I think" or "we believe" in their complaints. Optimistic prognostications by executives that turn out to be false will present new pleading opportunities, and the chances of getting past a motion to dismiss are markedly improved.

And as most seasoned plaintiffs lawyers know, once you get past the motion to dismiss some kind of settlement is virtually assured, even if only to avoid the expense of discovery.

Lessons for Securities Issuers

For issuers of securities and their investor relations departments, Abramson deserves careful attention. It is especially important to keep in mind that while this may seem most relevant to public companies, Rule 10b-5 applies to issuers of exempt securities too. Appropriately disciplined statements in offering memoranda and other marketing materials can help keep them out of trouble.

Previously, statements of opinion were practically impervious to attack in a 10b-5 action. A plaintiff would have to plausibly allege that the opinion was not genuinely held and that the underlying fact was untrue—a nearly insurmountable pleading burden, as the Second Circuit noted.

Abramson, following Omnicare, gives plaintiffs a much broader range of statements to examine and a road map for getting their complaints past a motion to dismiss. This is especially relevant given the consequences of a plaintiff overcoming a motion to dismiss.

Once the automatic stay of the Private Securities Litigation Reform Act disappears, costs of defense mount very quickly even in an otherwise weak case. Even a nuisance-value settlement could be substantial, and seasoned defense lawyers know that once you start looking through everyone's emails you never know what you will find, and the surprises are rarely good.

Corporate officers who speak on behalf of the company should receive training on how to express opinions with appropriate care. So, too, drafters of corporate disclosures should be attentive to the bases for any opinions expressed. This includes prospectuses, periodic reporting, offering memoranda — anything that goes to investors or potential investors,

whether for public or exempt issues.

This may be of special relevance to pharmaceutical companies and other companies whose products have long development times with blockbuster potential, but which are subject to unpredictable contingencies. The financial press inevitably wants to know about the prospects for success, and the company of course wants to express optimism.

Abramson counsels caution. Companies should be vigilant to ensure that statements of opinion are consistent with the information available to them and do not imply the existence of facts the company does not have or investigations the company has not done.

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