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High Court Sets Stage For Another Section 11 Circ. Split

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Less than a week after the U.S. Supreme Court's decision in Omnicare,[1] the Supreme Court granted a writ of certiorari, vacated the judgment and remanded Freidus v. ING Groep NV[2] to the Second Circuit for further consideration due to its Omnicare decision. In doing so, the court may have set the stage for another split between the Sixth and Second Circuits, this time regarding the application of the court's newly articulated standard for claims based on §11's omissions provision.[3]

On March 24, 2015, the court remanded Omnicare to the Sixth Circuit holding that for purposes of §11's false-statement provision "a sincere statement of pure opinion is not an 'untrue statement of material fact,' [for purposes of §11] regardless whether an investor can ultimately prove the belief wrong."[4] Important for the remands in Omnicare and Freidus is the court's subsequent holding that "if 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[5] would take from the statement itself, then §11's omissions clause creates liability."[6]

The court provided the following guidance, and admonition, to lower courts seeking to apply Omnicare's §11 omissions provision:

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.[7]

Predicting how these cases will be decided on remand would be speculative at best. However, given the Sixth and Second Circuits' previously differing view on the scope of §11 liability,[8] applying the Supreme Court's §11's omissions standard to these recently remanded cases may set the stage for another split between these circuits.

Omnicare is based on two opinion statements in a 2005 registration statement where the company essentially said "'we believe we are obeying the law.'"[9] In January 2006, several government raids

were conducted on Omnicare facilities that resulted in two large settlements.[10] Plaintiffs sued the company, its CEO, chief financial officer, secretary, chairman of the board, and one of its directors claiming that given Omnicare's alleged illegal activities, its prior statements regarding "legal compliance" were false when made, triggering liability under §11.

Freidus is based on ING's opinion statement in September 2007 that it "considers its subprime [and] Alt–A ... exposure to be of limited size and of relatively high quality."[11] ING issued securities, disclosing in its offering documents that part of its investment portfolio included interest it owned in several residential mortgage-backed securities (RMBS). When the value of ING's securities declined, plaintiffs sued the company, its underwriters, officers and executive board members alleging, in the district court's words, that "'ING's statement that it considered its assets to be of 'relatively high quality' was inaccurate or incomplete in September 2007 because it did not disclose the types of loans in the pools underlying ING's ... [residential mortgage-backed securities] or the places and years in which they were originated.'"[12]

In Omnicare, the court determined that the plaintiffs had raised a discrete omissions claim concerning legal compliance,[13] noting that during oral argument, plaintiffs "highlighted" that "an attorney had warned Omnicare that a particular contract 'carrie[d] a heightened risk' of legal exposure under anti-kickback laws." [14] On remand, the Sixth Circuit will have to determine whether this constitutes an actionable omission under §11.

In Freidus, the district court noted that the complaint described "the creation of the 'housing bubble,' the types of mortgage loans issued during 2006 and 2007, and their delinquency and default rates 'at the end of 2007' or later. It describe[d] also the proportions of the pools underlying ING's RMBS that each of the allegedly 'risky' types of loans constituted. It finally describe[d], in general terms, the marketwide increase in default rates on the mortgages underlying RMBS, the resulting 'substantial distress' in the market for Alt–A and subprime RMBS, the downgrading of credit ratings attached to some tranches of RMBS, and the fact that other banks at different times beginning in October 2007 revealed losses on their mortgage-related assets."[15] On remand, the Second Circuit will have to determine whether the information plaintiffs claim was omitted from ING's RMBS ownership disclosures constitutes an actionable omission under §11.

Although the Second Circuit's opinion provides little insight into how it may decide the matter on remand, at least the district court in Freidus appeared critical of the adequacy of these items, stating that "[i]n many cases, [plaintiffs'] allegations post-date the statements in the offering materials alleged to be misleadingly incomplete. In most cases, they describe conditions related to the individual mortgage loans, not the securities structured around them. None describe ING's assets — the allegations concern the market generally, other securities, or the actions of other institutions. Perhaps most importantly, the only allegations that concern Alt–A and subprime RMBS — the categories of assets ING owned — before September 2007 discuss the performance of tranches that were lower-rated, and therefore riskier and more prone to loss, than those that ING held."[16]

Based on this analysis, the district court in Freidus concluded that "[s]uch allegations are, at best, consistent with a theory that ING's assets were 'extremely risk' or not of 'relatively high quality' in September 2007 and therefore not of 'relatively high quality.' But absent some factual allegations suggesting that ING's assets had been impacted by the general market conditions at the time the allegedly misleading statements were made, the [complaint] 'stops short of the line between possibility and plausibility' that the September 2007 Offering Materials were misleading in a way that required additional disclosure. It therefore fails to state a claim on this basis." [17]

Plaintiffs in both cases disavowed claims based on fraud.[18] Thus, whether the opinions expressed in Omnicare and Freidus meet the standard required by §11's omissions provision will be one of the issues considered on remand in both cases. While it is unclear whether the quantity and quality of the allegations made in Freidus and Omnicare will be sufficient to meet the court's newly articulated §11 omissions standard or not, what is clear is that Freidus and Omnicare will provide the Second and Sixth Circuits with the opportunity to again disagree on the scope of §11.

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[1] Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, No. 13-435, 575 U.S.___ (Mar. 24, 2015).

[2] Freidus v. ING Groep NV, No. 13-1505, 2015 WL 1400851 (U.S. Mar. 30, 2015).

[3] Section 11 of the Securities Act of 1933 ("Section 11") provides a private remedy for securities purchasers if the 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 statement therein not misleading." 15 U.S.C. § 77k. Section 11 claims do not require scienter — or intent to deceive.

[4] Omnicare, 575 U.S.___ at 9. ("In other words, the provision is not, as the Court of Appeals and the Funds would have it, an invitation to Monday morning quarterback an issuer's opinions.")

[5] The court determined that a "reasonable investor" could not "expect that every fact known to an issuer supports its opinion statements," that "[t]he reasonable investor understands a statement of opinion in its full context, and §11 creates liability only for the omission of material facts that cannot be squared with such a fair reading," and that for expressions of opinion, determining "what [a reasonable investor] would naturally understand a statement to convey beyond its literal meaning ... means considering the foundation [the reasonable investor] would expect an issuer to have before making the statement." Id., 575 U.S.___ at 13-17.

[6] Id., 575 U.S.___ at 12.

[7] Id., 575 U.S.___ at 18.

[8] In reversing the district court's dismissal of the §11 claims in Omnicare, the Sixth Circuit expressly declined to follow Fait v. Regions Financial Corp., 655 F.3d 105 (2d Cir. 2011).

[9] Omnicare, 575 U.S.___ at 9.

[10] See e.g., Indiana State Dist. Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare Inc., 583 F.3d 935, 941 (6th Cir. 2009)("Omnicare I"). In Omnicare I, the Sixth Circuit upheld the dismissal of Section 10(b) claims stating that "the complaint fails specifically to allege that

defendants knew their statements of 'legal compliance' were false when made," and remanded the Section 11 claims.

[11] Freidus v. ING Groep NV, 736 F. Supp. 2d 816, 823 (S.D.N.Y. 2010).

[12] Freidus v. ING Groep NV, 543 F. App'x 93, 95 (2d Cir. 2013).

[13] Omnicare, 575 U.S.___ at 5, n.1.

[14] Id., 575 U.S.___ at 19-20.

[15] Freidus v. ING Groep NV, 736 F. Supp. 2d 816, 832 (S.D.N.Y. 2010).

[16] Id.

[17] Id.

[18] Omnicare, 575 U.S. ____ at 4; Freidus v. ING Groep N.V., 736 F. Supp. 2d 816, 827 (S.D.N.Y 2010) (Complaint "specifically disclaims any claim of fraud.").
