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The Tenth Circuit Rejects Section 11 Claims for "False" Opinions

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On August 1, 2014, the Tenth Circuit issued its decision in *MHC Mutual Conversion Fund, L.P. v. Sandler O'Neill & Partners, L.P.* ("*MHC Mutual*"), addressing whether opinions contained in securities offering documents can be actionable under section 11 of the Securities Act of 1933.[1] The Tenth Circuit joined the Second, Third, and Ninth Circuits in deciding that an opinion about future events is not false or misleading under section 11 simply because the opinion later turns out to be wrong. Rather, the opinion can only be deemed false if the speaker did not subjectively believe the opinion when it was expressed or—possibly—if the speaker lacked a reasonable basis for the statement. In reaching this conclusion, the Tenth Circuit expressly rejected the Sixth Circuit's holding in *Omnicare*,[2] which the Supreme Court will review in the upcoming term.

Opinion Liability Under Section 11

Section 11 provides a civil cause of action for investors when registration statements contain material misstatements or omissions.[3] Section 11 generally does not require any showing of scienter or reliance, meaning that plaintiffs can establish liability by demonstrating that the registration statement contained a materially false or misleading statement.[4] However, by the terms of the statute, the false or misleading statement must be related to a material *fact*, raising the question: *Do expressions of opinion ever amount to material fact*?

In 1991, the Supreme Court addressed this question in *Virginia Bankshares, Inc. v. Sandberg*, a case evaluating opinion liability under section 14 of the Securities Exchange Act of 1934.[5] There, the Court determined that opinion liability might exist if (1) the opinion offered was not believed by its speaker at the time it was made ("subjective falsity"), and (2) the opinion turned out to be false ("objective falsity").[6] This standard, requiring both subjective and objective falsity, has since been applied to section 11 claims by a majority of the circuit courts.[7]

Omnicare

In *Omnicare*, the Sixth Circuit declined to follow *Virginia Bankshares* on the grounds that *Virginia Bankshares* dealt with a section 14 claim (*i.e.*, a '34 Act claim with an express scienter requirement); in the Sixth Circuit's view, it did not apply to a section 11 claim (*i.e.*, a '33 Act claim which generally contains no scienter requirement). The Sixth Circuit held that section 11 imposes strict liability—even as to statements of opinion and belief. The Sixth Circuit concluded that *Virginia Bankshares* thus "has very limited application to [section] 11," and held that only objective falsity is necessary to state a

section 11 claim.[8] As noted, the Sixth Circuit's decision is a departure from the majority view, and is currently on appeal to the Supreme Court.

MHC Mutual

The allegations in *MHC Mutual* involve statements made in the immediate aftermath of the 2008 financial crisis. At the time, United Western Bancorp, Inc. ("Bancorp") sought to conduct a secondary stock offering to raise about $90 million.[9] Bancorp disclosed that it had significant investments in mortgage-backed securities, which had suffered from the rash of homeowner defaults occurring in the midst of the financial crisis, and that the company had lost $47 million on its investments.[10] However, Bancorp stated that it had "conducted internal analyses and consulted independent experts and now expected the level of delinquencies and defaults to level off and the market for its securities to rebound."[11] In connection with this last statement, Bancorp cautioned that if adverse market conditions persisted, the company would have to recognize further losses.[12]

The recession, of course, persisted longer than Bancorp had projected, and, fifteen months after the secondary offering, the company was forced to recognize another $69 million in losses.[13] The plaintiffs sued, alleging that the opinion Bancorp gave in its secondary offering regarding the prospects for its securities portfolio was false and gave rise to opinion liability under section 11.[14] The district court disagreed and dismissed the plaintiffs' claims; the appeal to the Tenth Circuit followed.[15]

The Tenth Circuit affirmed the dismissal. In doing so, the Tenth Circuit clearly disagreed with the Sixth Circuit's reasoning in *Omnicare*, dismissing the decision in a brief footnote:

> Recently, the Sixth Circuit suggested that objective falsity alone, without more, is enough [to impose section 11 liability]. In doing so, though, the Sixth Circuit didn't address its own prior decision in *Mayer* holding that both objective falsity and subjective disbelief are required. And, as we've seen, *Omnicare*'s result stands in a good deal of tension with the common law, securities law authorities, and experience suggesting that *the failure of an opinion about future events to materialize, without more, doesn't establish that the opinion was a false or misleading statement* of fact at the time it was made.[16]

Instead of following the *Omnicare* approach, the Tenth Circuit conducted a thorough examination of the legislative history of section 11 and more than a century's worth of tort doctrine in order to answer the question it posed to itself: "When does section 11 of the Securities Act of 1933 impose liability on issuers who offer opinions about future events?"[17]

The court concluded that there are "at least three possible readings of section 11 when it comes to opinion liability."[18] Specifically:

1. Based upon common law at the time section 11 was enacted, there is no liability for opinions about future events.[19]

2. Based upon *Virginia Bankshares* and numerous subsequent cases, opinion liability only exists under section 11 where there is both objective and subjective falsity.[20]

3. Based upon present-day common law, opinion liability may exist when a speaker offers an opinion without an objectively reasonable basis for doing so, even if the speaker truly believed in the opinion.[21]

Without explicitly choosing between these three approaches (although its decision implicitly operates at a remove from the first alternative), the Tenth Circuit concluded that more than objective falsity is required in order to impose opinion liability under section 11.[22] The court did not, however, choose between the second and third approaches, finding that the plaintiffs had failed to allege facts sufficient to satisfy either approach.[23] In particular, the court found that there was clearly a reasonable basis for Bancorp's statements, given that numerous independent investment analysts had reached the same conclusions and that Bancorp had expressly disclosed that its opinion was based on judgments about future economic trends that might not hold.[24]

As the Supreme Court gears up to hear *Omnicare*, *MHC Mutual* presents yet another case supporting the view that section 11 claims cannot arise simply from opinions that turn out in hindsight to be false or misleading. Rather, *MHC Mutual* holds that such statements should only be actionable under section 11, when the speaker does not actually believe the opinion or—possibly—when the speaker lacks a reasonable basis for the opinion.

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1 No. 13-1016, --- F.3d ---, 2014 WL 3765717 (10th Cir. Aug. 1, 2014).

2 *Ind. State Dist. Council of Laborers & HOD Carriers Pension & Welfare Fund v. Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013) ("*Omnicare*"), *cert. granted*, 134 S. Ct. 1490 (U.S. 2014).

3 *See* 15 U.S.C. § 77k(a).

4 Plaintiffs must also plead the existence of damages. *See* § 77k(e).

[5] 501 U.S. 1083 (1997).

[6] *Id.* at 1097.

[7] *See, e.g., Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011); *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156 (9th Cir. 2009); *In re Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357 (3d Cir. 1993).

[8] 719 F.3d at 507.

[9] No. 13-1016, --- F.3d ---, 2014 WL 3765717, at *1 (10th Cir. Aug. 1, 2014).

[10] *Id.*

[11] *Id.*

[12] *Id.*

[13] *Id.*

[14] *Id.*

[15] *See id.*; *MHC Mut. Conversion Fund, L.P. v. United W. Bancorp, Inc.*, 913 F. Supp. 2d 1026, 1037 (D. Colo. 2012).

[16] *Id.* at n. 2 (emphasis added) (internal citations omitted).

[17] *MHC Mutual*, 2014 WL 3765717, at *1.

[18] *Id.* at *3.

[19] *See id.* at *2-3 ("If section 11's terms were best understood [in light of the common law as it existed in 1933], the resolution of this appeal would of course be pretty simple. To the extent the plaintiffs complain about the defendants' opinion about future events, there could be no liability.").

[20] *See id.* at *4 (stating that under the second possible reading of section 11's opinion liability, "a plaintiff must show *both* that the defendant expressed an opinion that wasn't his real opinion . . . *and* that the opinion didn't prove out in the end" (emphasis in original)).

[21] *See id.* at *5-6 (describing the third possible reading of section 11's opinion liability and referring to it as the "objectively reasonable basis test").

[22] *See id.* at *1 ("Establishing that an opinion about the future failed to pan out in the end may go some way to meeting [section 11's false or misleading] standard *but it doesn't go all the way*." (emphasis added)).

[23] *See id.* at *6 ("For our present purposes, however, we don't have to resolve any of these questions [regarding the standard to be applied]. . . . The plaintiffs' complaint still fails.").

[24] *Id.* at *7.