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Defending 1933 Act Claims: Rewriting The Playbook After *Fait v. Regions Fin. Corp.*

BY PAUL DUTKA

Representing a defendant, especially an issuer, in Securities Act litigation has always been a daunting task. All that a plaintiff has needed to plead and prove a *prima facie* claim under Sections 11 or 12(a)(2) is that the plaintiff purchased a registered security and that the underlying registration statement or prospectus, respectively, contained a misstatement or omission of material fact.[1] ''Claims under sections 11 and 12(a)(2) are . . . Securities Act siblings with roughly parallel elements, notable . . . for . . . the *in terrorem* nature of the liability they create.''[2] Issuers in particular ''are subject to 'virtually absolute' liability under section 11 . . . .''[3]

In a decision that has garnered surprisingly scant attention, the U.S. Court of Appeals for the Second Circuit in *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011), gave motions to dismiss and substantive motions under the 1933 Act new reach and heft. *Fait* held that when the alleged misstatement or omission of material fact is an opinion, a plaintiff must also plead and prove both that the opinion was wrong (''objective falsity'') and that the opinion's author did not believe it at the time (''subjective falsity''). Following *Fait,* courts have broadly construed opinions to include statements in registration statements and prospectuses regarding conformity with generally accepted accounting principles (''GAAP'') and generally accepted auditing standards (''GAAS''), accounting valuations, credit and securities analysts' ratings, fairness of business combinations, and issuers' business operations and

[1] *Rombach v. Chang*, 355 F.3d 164, 169 n.4 (2d Cir. 2004); *In re Gen. Elec. Sec. Litig.*, 856 F. Supp. 2d 645, 652 (S.D.N.Y. 2012) (Weil represented General Electric in this litigation).

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[2] *In re Morgan Stanley Info. Fund Sec. Litig.*, 592 F.3d 347, 359 (2d Cir. 2010) (citing *Pinter v. Dahl*, 486 U.S. 622, 646 (1988); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381–82 (1983)).

[3] *Id.* (citing *Herman & MacLean*, 459 U.S. at 382).

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performance.[4] And having found that the alleged misstatement or omission is an opinion, following *Fait*, many courts have dismissed complaints for failing to adequately plead objective and subjective falsity.[5]

Fait may soon emerge from obscurity and command center stage. *Fait* represents an extension to the 1933 Act of *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083 (1991), in which the U.S. Supreme Court first announced the ''objective-subjective'' falsity test in the context of a misleading proxy claim under Section 14(a) of the Securities Exchange Act. The U.S. Court of Appeals for the Ninth Circuit in *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156 (9th Cir. 2009), has extended *Va. Bankshares* similarly.[6] But in May, the U.S. Court of Appeals for the Sixth Circuit created a circuit split by rejecting *Fait* and *Rubke*, perhaps laying the groundwork for the first major Supreme Court decision on the 1933 Act in decades and one that could alter the dynamics of 1933 Act litigation.[7]

Part I of this article summarizes *Va. Bankshares* and *Fait*. Part II discusses how courts determine whether a statement is an opinion, and the types of statements that courts have held to be opinions. Part III discusses objective and subjective falsity and several questions regarding subjective falsity. These include (a) whether subjective falsity and scienter are the same; and (b) whether pleading subjective falsity requires meeting the heightened pleading requirements of Federal Rule of Civil Procedure 9(b). Part IV discusses how the Second Circuit has extended *Fait* to 1934 Act claims, and, finally, Part V discusses the circuit split that the Sixth Circuit recently created in *Ind. State Dist. Council v. Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013).

I. *Virginia Bankshares* and *Fait*

In *Va. Bankshares*, the U.S. Supreme Court addressed two questions: (a) whether a misleading proxy claim under Section 14(a) can be based on a defendant's opinion (Rule 14a-9 requires a misstatement or omission of material fact) and (b) whether minority shareholders, whose votes were not required by law or corporate bylaw to authorize the corporate acts for which the proxy was solicited, have standing under Section 14(a). Plaintiffs claimed defendant directors had misleadingly opined in a proxy statement that shareholders should approve a short-form merger ''because of its opportunity for the minority shareholders to achieve a 'high' value, which [the directors] elsewhere described as a 'fair' price, for their stock.''[8] After a lengthy discussion, the Supreme Court strongly suggested that a materially misleading opinion can give rise to Section 14(a) liability if the opinion is both objectively and subjectively false. In his concurrence, Justice Scalia summarized this portion of the majority's opinion as follows:

> As I understand the Court's opinion, the statement ''In the opinion of the Directors, this is a high value for the shares'' would produce liability if in fact it was not a high value and the directors knew that. It would not produce liability if in fact it was not a high value but the directors honestly believed otherwise.[9]

The Supreme Court held that plaintiffs lacked standing to bring a Section 14(a) claim.

Fait addressed alleged violations of Sections 11, 12, and 15 of the 1933 Act. Plaintiffs claimed that a registration statement and prospectus supplement were false and misleading because they incorporated by reference financial statements that plaintiffs alleged overstated goodwill and underestimated loan loss reserves.[10] District Judge Lewis Kaplan determined that the goodwill valuation and provision for loan losses were both opinions, reasoning that they were matters of judgment not subject to any objective standard of valuation.[11] Judge Kaplan held that ''[a]n opinion is actionable under Section 11 or 12 only if the complaint alleges that the speaker did not truly hold the opinion at the time it was issued,''[12] citing *Va. Bankshares, In re Lehman Bros. Sec. & ERISA Litig.*, 684 F. Supp. 2d 485 (S.D.N.Y. 2010), and *In re AOL Time Warner Sec. & ERISA Litig.*, 381 F. Supp. 2d 192 (S.D.N.Y. 2004).[13] Judge Kaplan dismissed the complaint, concluding that plaintiffs had failed to allege that defendants ''knowingly or recklessly'' misstated goodwill or the loan loss reserves or ''did not truly hold the opinions at the time they were made public.''[14]

The Second Circuit affirmed, *Fait v. Regions Fin. Corp.*, 655 F.3d 105 (2d Cir. 2011), and relied on *Va. Bankshares* for the objective-subjective falsity requirement.[15] The court also looked to the Ninth Circuit for guidance. In *Rubke v. Capitol Bancorp, Ltd.*, the Ninth Circuit had held that ''opinions . . . can give rise to a claim under section 11 only if the complaint alleges . . . that the statements were both objectively and subjectively false or misleading.''[16] Additionally, the Second Circuit pointed to its decisions in *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124 (2d Cir. 1994) (a 1934 Act decision),[17] *Friedman v. Mohasco Corp.*, 929 F.2d 77

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[4] *See infra*.

[5] *See infra*.

[6] 551 F.3d 1156, 1162 (9th Cir. 2009).

[7] *Ind. State Dist. Council v. Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013).

[8] *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1088 (1991).

[9] *Id.* at 1108–09 (Scalia, J., concurring in part and concurring in the judgment).

[10] *Fait v. Regions Fin. Corp.*, 712 F. Supp. 2d 117, 119–20 (2d Cir. 2011). The complaint also alleged that the offering documents were misleading because they stated that the goodwill valuation and provision for loan losses complied with GAAP and the Sarbanes-Oxley Act. The court dismissed these claims as duplicative and unsupported by appropriate facts, and therefore insufficient to state a claim. *Fait*, 712 F. Supp. 2d at 120, 125.

[11] *Fait*, 712 F. Supp. 2d at 122, 124.

[12] *Id.* at 121.

[13] *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1092–96 (1991); *In re Lehman Bros. Sec. & ERISA Litig.*, 684 F. Supp. 2d 485, 494 (S.D.N.Y. 2010) (''An opinion is actionable under [Section 11] only if the complaint alleges that the speaker did not truly have the opinion at the time it was issued.''); *In re AOL Time Warner Sec. & ERISA Litig.*, 381 F. Supp. 2d 192, 243 (S.D.N.Y. 2004) (In this 1934 Act case, the court pointed out that courts in the Second Circuit have read *Va. Bankshares* as holding that ''a statement of opinion is false and actionable only if the opinion is both (1) not believed by the speaker, and (2) objectively untrue.'').

[14] *Fait*, 712 F. Supp. 2d at 122–25.

[15] *Va. Bankshares* at 1108–09 (Scalia, J., concurring in part and concurring in the judgment).

[16] 551 F.3d 1156, 1162 (9th Cir. 2009).

[17] *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 112 (2d Cir. 2011) (citing *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124,

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(2d Cir. 1991) (a 1933 and 1934 Act decision),[18] and *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259 (2d Cir. 1993) (a 1934 Act decision).[19]

II. Opinions under *Fait*

Following *Fait,* courts have held that opinions include statements in registration statements and prospectuses regarding conformity with GAAP and GAAS,[20] accounting valuations,[21] credit and securities analysts' ratings,[22] fairness of business combinations,[23] and issuers' business operations and performance.[24] In doing so, courts have taken one of three approaches to determine whether a statement is an opinion.[25] The first is ''I know it when I see it.'' Courts taking this approach ''merely characterize[e] certain statements as opinions without articulating a rationale.''[26] The next is the ''literal test.'' Courts applying this approach ''give great weight to the inclusion of phrases like 'I think,' 'I believe,' and 'in my opinion' when analyzing whether an alleged misrepresentation is a statement of opinion or fact, apparently without regard to the substance of the representation following that phrase.''[27] Finally, some courts ''characterize[] opinions as statements that involve judgment or subjectivity.''[28] This is the dominant approach in the Second Circuit. Often, when using this test, judges use words such as ''subjective'' and ''judgment'' for opinions, and ''objective'' for facts. Matters of opinion include subjective statements that reflect ''judgments as to values that [are] not objectively determinable.''[29] For instance, in *Fait*, the Second Circuit emphasized the absence of any objective standard for determining goodwill, ''such as market price.'' The court also pointed out that ''[a]bsent such a standard, an estimate of the fair value of those assets will vary depending on the particular methodology and assumptions used.''[30] ''In other words, the statements regarding goodwill at issue here are subjective ones rather

1131 (2d Cir. 1994) (The Second Circuit stated that ''[a] statement of reasons, opinion or belief . . . can be actionable under the securities laws if the speaker knows the statement to be false.'')).

[18] *Id.* at 112 (citing *Friedman v. Mohasco Corp.*, 929 F.2d 77, 78–79 (2d Cir. 1991) (a pre-*Va. Bankshares* case, in which the court held that the complaint did not state a claim ''by alleging that defendants represented that securities to be issued would, in the opinion of financial advisors, have a specified market value and that the securities, when issued, did not attain the hoped for value'' when there was no guarantee of market value and when there was no allegation that the financial advisors did not hold that opinion)).

[19] *Id.* (quoting *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 266 (2d Cir. 1993) (expressions of opinion ''in a company's statements about its future prospects'' were not actionable because plaintiffs failed to allege that defendants did not hold the opinions and that the opinions were not based in fact)).

[20] *See MHC Mut. Conversion Fund, L.P. v. United W. Bancorp, Inc.*, No. 11-cv-00624-WYD-MJW, 2012 BL 387633, at *9 (D. Colo. Dec. 19, 2012) (determination whether a security is other-than-temporarily impaired under GAAP is an opinion; the court dismissed plaintiff's claims because of plaintiff's failure to plead subjective falsity); *In re Am. Int'l Grp., 2008 Sec. Litig.*, No. 08 Civ. 4772 (LTS)(DCF), 2013 BL 112330, at *4–6 (S.D.N.Y. Apr. 26, 2013) (citing *In re Lehman Bros. Sec. & Erisa Litig.*, 799 F. Supp. 2d 258, 291 (S.D.N.Y. 2011) (''The decision not to disclose credit risk pursuant to Financial Accounting Standard 107 is . . . tantamount to an implicit representation that management was not of the opinion that the concentration of credit risk was significant.'' The court dismissed plaintiff's claims regarding FAS 107 and FIN 45 for failure to plead subjective falsity. Audit opinions were also subject to *Fait*'s subjective falsity requirement.)); *but see In re Wash. Mut., Inc. Sec.*, 694 F. Supp. 2d 1192, 1223–24 (W.D. Wash. 2009) (Whether Deloitte's internal control reports on Washington Mutual conformed with the Public Company Accounting Oversight Board's standards was a ''verifiable factual statement.'' The court also held that the statement that financials were prepared in accordance with GAAP was a statement of fact.).

[21] *See also Fait v. Regions Fin. Corp.*, 655 F.3d 105, 110–11, 113 (2d Cir. 2011) (statements of goodwill and loan loss reserves were statements of opinion); *Fed. Hous. Fin. Agency v. SG Ams., Inc.*, No. 11 Civ. 6203 (DLC), 2012 BL 309466, at *3 (S.D.N.Y. Nov. 27, 2012) (statements of loan-to-value ratios were opinions); *In re Deutsche Bank Ag Sec. Litig.*, No. 09 Civ. 1714 (DAB), slip op. at 5 (S.D.N.Y. Aug. 10, 2012) (valuations, based on a bank's internal systems, of subprime and mortgage-backed assets were opinions, claims dismissed, with prejudice and without leave to replead, for failure to plead subjective falsity).

[22] *In re Lehman Bros. Sec. & ERISA Litig.*, 684 F. Supp. 2d 485, 495–96 (S.D.N.Y. 2010) (Whether credit enhancements were adequate to support pass-through certificate ratings was an opinion. ''It was . . . a statement of opinion by each ratings agency that it believed, based on the methods and models it used, that the amount and form of credit enhancement built into each [c]ertificate, along with the [c]ertificate's other characteristics, was sufficient to support the rating assigned to it.'' The court dismissed the Section 11 claims for failure to plead subjective falsity.); *Stumpf v. Garvey (In re TyCom Ltd. Sec. Litig.)*, No. 03-CV-1352-PB, 2005 BL 30671, at *18 (D.N.H. Sept. 2, 2005) (treating securities analyst reports as opinions).

[23] *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156, 1162 (9th Cir. 2009) (court determined that fairness opinions evaluating a share exchange offering were opinions and dismissed the complaint, in part because plaintiffs failed to plead subjective falsity); *In re AOL Time Warner Sec. & ERISA Litig.*, 381 F. Supp. 2d 192, 243 (Morgan Stanley's determination that the exchange ratio between Time Warner and AOL stock was fair to Time Warner shareholders was an opinion. The court dismissed plaintiff's Section 11 and 14(a) claims for failure to plead subjective falsity.).

[24] *See, e.g.*, *In re Gen. Elec. Sec. Litig.*, 856 F. Supp. 2d 645, 656–57 (S.D.N.Y. 2012) (GE executive's statement that ''in the recent market volatility, we continue to successfully meet our commercial paper needs'' and a statement in GE's prospectus supplement that ''[t]here can be no assurance that [commercial paper] markets will continue to be a reliable source of short-term financing for GE Capital'' were both opinions. The court dismissed plaintiffs' commercial paper Securities Act claims in part because of plaintiffs' failure to plead subjective falsity.); *In re AES Corp. Sec. Litig.*, 825 F. Supp. 578, 588 (S.D.N.Y. 1993) (noting in dictum that statements about ''commitment to ethical and environmental values, or . . . achievements,'' may be opinions).

[25] Wendy Gerwick Couture, *Opinions Actionable As Securities Fraud*, 73 La. L. Rev. 381, 401 (2013).

[26] *Id.*

[27] *Id.* at 402.

[28] *Id.* (citing *In re Credit Suisse First Bos. Corp.*, 431 F.3d 36, 47 (1st Cir. 2005) (''[M]ost stock analysts' ratings are statements of opinion because '[a]rmed with the same background facts, two knowledgeable analysts, each acting in the utmost good faith, could well assign different ratings to the same stock' '')).

[29] *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 109 (2d Cir. 2011) (citation omitted).

[30] *Id.* at 111.

than 'objective factual matters.' ''[31] Similarly, with regard to loan loss reserves, *Fait* held that ''determining the adequacy of loan loss reserves is not a matter of objective fact.'' Rather ''loan loss reserves reflect management's opinion or judgment about what, if any, portion of amounts due on the loans ultimately might not be collectible.'' The court pointed out that this determination is ''inherently subjective'' and plaintiff ''did not point to an objective standard for setting loan loss reserves.''[32]

III. Objective and Subjective Falsity and Scienter

After the alleged misstatement or omission has been found to be an opinion, *Fait* holds that ''liability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was expressed.''[33] Objective falsity means that the opinion must be ''false or misleading with respect to the underlying subject matter [the opinion] address[es].''[34] For instance, in *Fed. Hous. Fin. Agency v. UBS Ams., Inc.*, 858 F. Supp. 2d 306, 328 (S.D.N.Y. 2012), which involved residential mortgage-backed securities, the court determined that loan-sampling results suggested widespread inaccuracies in housing appraisal values. These inaccuracies rendered plausible plaintiff's claim that the loan-to-value information reported in the offering materials was ''objectively false.''[35] Pleading subjective falsity, i.e., whether the opinion's author did not believe it at the time, is more nuanced and raises several questions, including how pleading subjective falsity differs from pleading scienter and whether pleading subjective falsity must meet the heightened pleading requirements of Federal Rule of Civil Procedure 9(b).

A. Subjective Falsity and Scienter

In *Fait*, the Second Circuit—in a footnote and without elaboration—distinguished pleading subjective falsity from pleading scienter. ''Contrary to plaintiff's concern, the standard applied here does not amount to a requirement of scienter. We do not view a requirement that a plaintiff plausibly allege that defendant misstated his truly held belief and an allegation that defendant did so with fraudulent intent as one and the same.''[36] This distinction is not self-evident. Indeed, then-District Judge Lynch held, in the context of a 1934 Act claim:

> Although in the typical case falsity and scienter are different elements, in a false statement of opinion case the two requirements are essentially identical. For example, in a case where a material misstatement of fact is alleged, the statement may be both objectively false *and* believed in good faith by the speaker to be true. However, in contrast, a material misstatement of opinion is by its nature a false statement, not about the objective world, but about the defendant's own belief. Adequately alleging the falsity of a statement like ''I believe XO will become profitable'' is the same as adequately alleging scienter on the part of the speaker, since the statement (unlike a statement of fact) cannot be false at all unless the speaker is knowingly misstating his truly held opinion.[37]

A number of other courts have also held that subjective falsity and scienter are essentially the same.[38]

On the other hand, in *Fed. Hous. Fin. Agency v. UBS Ams., Inc.*, Judge Cote adhered to *Fait*'s distinction. In that case, the opinions were statements by non-party appraisers. Judge Cote held that plaintiffs needed to plead subjective falsity only for the appraisers, rather than for any individual who later reported their opinions. Judge Cote explained, ''[o]nce it is acknowledged that the 'subjective falsity' inquiry is directed at determining the truth of the statement, 'I believe,' rather than the fraudulent intent of any defendant who later reports that claim, the distinction [between scienter and subjective falsity] becomes clearer.''[39]

B. Whether a Plaintiff Pleading Subjective Falsity Needs to Meet the Heightened Pleading Requirements of Federal Rule of Civil Procedure 9(b)

Although *Fait* distinguished pleading subjective falsity from pleading scienter, the question whether a plaintiff pleading subjective falsity must nonetheless meet the heightened pleading requirements of Federal Rule of Civil Procedure 9(b) remains largely unaddressed. Generally, Federal Rule of Civil Procedure 8(a)(2) governs 1933 Act pleadings. Rule 8(a)(2) requires that a complaint contain a ''short and plain statement of the claim showing that the pleader is entitled to relief.'' Although this rule ''does not require detailed factual allegations, . . . a complaint must contain suffi-

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[31] *Id.* at 110–11 (citing *I. Meyer Pincus & Assocs., P.C. v. Oppenheimer & Co., Inc.*, 936 F.2d 759, 762 (2d Cir.1991)).

[32] *Id.* at 113 (citations omitted). *See also Fed. Hous. Fin. Agency v. SG Ams., Inc.*, No. 11 Civ. 6203 (DLC), 2012 BL 309466, at *3 (S.D.N.Y. Nov. 27, 2012) (Judge Cote held that statements of loan-to-value (''LTV'') ratios are opinions. ''Because LTV ratio is a function of appraisal valuation, and because valuations are . . . the subjective judgments of the appraisers, . . . the subject matter of the belief expressed—the true value of the property—is not a matter of objective fact, the accuracy of which can be challenged under the Securities Act.''); *In re Gen. Elec. Sec. Litig.*, 856 F. Supp. 2d 645, 656–57 (S.D.N.Y. 2012) (Judge Cote held that statements that ''in the recent market volatility, we continue to successfully meet our commercial paper needs'' and that ''[t]here can be no assurance that [commercial paper] markets will continue to be a reliable source of short-term financing for GE Capital'' were opinions. The court reasoned that ''[a] statement that a source of financing is 'reliable' involves an evaluation of the likelihood of events that is 'not objectively determinable,' and that is a matter of 'opinions or beliefs held.' '').

[33] *Fait v. Regions Fin. Corp.*, 655 F.3d 105, 110 (2d Cir. 2011).

[34] *Id.* at 111.

[35] *Fed. Hous. Fin. Agency v. UBS Ams., Inc.*, 858 F. Supp. 2d 306, 328 (S.D.N.Y. 2012).

[36] *Fait*, 655 F.3d at 114 n.5.

[37] *In re Salomon Analyst Level 3 Litig.*, 350 F. Supp. 2d 477, 490 (S.D.N.Y. 2004) (emphasis in original) (citing *DeMarco v. Lehman Bros.*, 309 F. Supp. 2d 631, 635 (S.D.N.Y. 2004)).

[38] *See, e.g.*, *Brown v. Credit Suisse First Bos. LLC (In re Credit Suisse First Bos. Corp. Analyst Reports Sec. Litig.)*, 431 F.3d 36, 48 (1st Cir. 2005) (stating, in a 10b-5 case, that ''the subjective aspect of the falsity requirement and the scienter requirement essentially merge; the scienter analysis is subsumed by the analysis of subjective falsity''); *City of Monroe Emps.' Ret. Sys. v. Hartford Fin. Servs. Grp.*, No. 10 Civ. 2835 (NRB), 2011 BL 238186, at *14 (S.D.N.Y. Sept. 19, 2011) (stating, in a 10b-5 case, that scienter and subjective falsity are essentially identical); *Stumpf v. Garvey (In re TyCom Ltd. Sec. Litig.)*, No. 03-CV-1352-PB, 2005 BL 30671, at *18 (D.N.H. Sept. 2, 2005) *(see infra)* (Weil represented one group of defendants in this litigation); *Podany v. Robertson Stephens, Inc.*, 318 F. Supp. 2d 146, 154 (S.D.N.Y. 2004) (accord, in a Section 10(b) case).

[39] *Fed. Hous. Fin. Agency v. UBS Ams., Inc.*, 858 F. Supp. 2d 306, 327 (S.D.N.Y. 2012) (Weil represented General Electric in this litigation).

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cient factual matter, accepted as true, to state a claim to relief that is plausible on its face.''[40] But in *Rombach*, the Second Circuit extended Rule 9(b)'s reach to Section 11 and Section 12(a)(2) claims when those claims are ''premised on averments of fraud.''[41] The Second Circuit reads Rule 9(b) to require that a complaint '' '(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent.' ''[42]

Cases holding that subjective falsity and scienter are the same, or that they are closely related, such as those discussed above, suggest that pleading subjective falsity must comply with Rule 9(b)'s heightened requirements. Indeed, at least one court has held this and another has directly suggested this. In *Stumpf v. Garvey (In re Ty-Com Ltd. Sec. Litig.)*, 2005 BL 30671 (D.N.H. Sept. 2, 2005), the court held that the Section 11 claims had to comply with Rule 9(b) for two reasons. First, the ''core allegations allege[d] a fraudulent scheme,'' because plaintiffs claimed, for example, that defendants ''deliberately misrepresented'' projections ''to defraud investors.''[43] Second, the court also held, citing Judge Lynch's opinion discussed above:

> Moreover, as to the allegations concerning analyst conflicts and false statements in analyst reports, plaintiffs must establish that the analysts knowingly misrepresented their actual opinions when they issued the reports. *See* [*In re Salomon Analyst Level 3 Litigation*], 350 F. Supp. 2d [477], 490 [(S.D.N.Y. 2004)] (explaining that ''adequately alleging the falsity of a statement [of opinion] . . . is the same as adequately alleging scienter.''). Accordingly, plaintiffs' § 11 claims concerning . . . analyst conflicts, and false reports must satisfy Rule 9(b).[44]

In *Belmont Holdings Corp. v. SunTrust Banks, Inc.*, 2010 BL 210983 (N.D. Ga. Sept. 10, 2010), plaintiff brought claims under Sections 11, 12, and 15 of the 1933 Act. The court held that the complaint did not sound in fraud. Therefore, Rule 8(a) applied. But the court added, with regard to statements of loan loss reserves, that these were statements of opinion, that the plaintiff had failed to plead that the defendant disbelieved the statements when made, and that if the plaintiff amended the complaint, ''[p]laintiff may be required to meet the heightened pleading standards of Rule 9(b).'' And the court observed, ''[i]n its current pleading, Plaintiff appears to be attempting to have it both ways, that is, disavowing a claim for fraud to avoid the need to meet the heightened pleading standard, at the same time suggesting that SunTrust's stated opinion was false . . . .''[45]

To be sure, in the *Fait* footnote discussed above, the Second Circuit, in distinguishing pleading subjective falsity from pleading scienter, referred to ''plausibly'' pleading subjective falsity. Although this would mean that Rule 8 applies to pleading subjective falsity, the Second Circuit was not presented with, and did not decide, the different question being considered here: whether under *Rombach*, pleading subjective falsity triggers Rule 9(b). It can also be argued that Rule 9(b) does not apply to pleading subjective falsity because Rule 9(b) contains an exception, that ''Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally.''[46] But a plaintiff commonly pleads subjective falsity by first pleading facts showing objective falsity and then by pleading defendants' knowledge of those facts, for example, through the receipt of e-mails and other contemporaneous communications, when they gave the opinion. As the U.S. Supreme Court observed in *Va. Bankshares*, ''it would be rare to find a case with evidence solely of disbelief or undisclosed motivation without further proof that the statement was defective as to its subject matter.''[47] For example, in *Abu Dhabi Commer. Bank v. Morgan Stanley & Co.*, 888 F. Supp. 2d 431 (S.D.N.Y. 2012), plaintiffs on summary judgment used contemporaneous knowledge of objective facts to plead subjective falsity. The opinions in the case were ratings of residential mortgage-backed securities. Plaintiffs showed that defendant rating agencies did not believe their opinions when they issued them, by pointing to defendants' e-mails, deposition testimony, and internal memoranda. According to that evidence, analysts ''observed that there was 'no actual data backing the current model assumptions' on the . . . deal,''[48] and admitted to having ''little knowledge of the U.S. RMBS market.''[49] Analysts

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[40] *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (citation omitted).

[41] *Rombach v. Chang*, 355 F.3d 164, 170 (2d Cir. 2004). Although the complaint in *Rombach* contained both 1933 and 1934 Act claims, it is settled that a complaint may contain only 1933 Act claims and still trigger Rule 9(b)'s heightened pleading requirements. *See McKenna v. Smart Techs.*, No. 11 Civ. 7673 (KBF), 2012 BL 78499, at *8–9 (S.D.N.Y. Apr. 3, 2012) (In this 1933 Act case, allegations that defendants ''(i) sought to hide unpleasant, known facts from the public—or the material impact of those facts on aspects of [defendant]'s business—and (ii) strategically timed the IPO to take advantage of certain known, but not-yet-disclosed facts, rendering the [o]ffering [d]ocuments materially false and misleading, amount[ed] to claims of purposeful, fraudulent conduct.''); *In re Leadis Tech. Sec. Litig.*, No. C 05-00882 CRB, 2006 BL 3762, at *3–5 (N.D. Cal. Mar. 1, 2006) (In this 1933 Act case, the court determined that the complaint sounded in fraud because the factual basis for plaintiffs' claims [was] that defendants knew that the cautionary warnings contained in the IPO prospectus addressed events that were already occurring. Defendants did not disclose that these events were already happening. Therefore, ''[t]his [was] a quintessential fraud claim.'').

[42] *Rombach*, 355 F.3d at 170 (citing *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1175 (2d Cir. 1993)). ''Fed.R.Civ.P. 9(b) requires the plaintiff to state 'with particularity' any 'circumstances constituting fraud . . . . This means the who, what, when, where, and how: the first paragraph of any newspaper story.'' *DiLeo v. Ernst & Young*, 901 F.2d 624, 627 (7th Cir. 1990).

[43] *Stumpf v. Garvey*, 2005 BL 30671, at *18.

[44] *Id.* (citing *In re Salomon Analyst Level 3 Litig.*, 350 F. Supp. 2d 477, 490 (S.D.N.Y. 2004)).

[45] *Belmont Holdings Corp. v. SunTrust Banks, Inc.*, No. 1:09-cv-1185-WSD (Consolidated), 2010 BL 210983, at *6–7 (N.D. Ga. Sept. 10, 2010). At least one district court appears to hold the view that Rule 8 applies to pleading subjective falsity. In *In re Apple REITs Litig.*, 2013 BL 92404 (E.D.N.Y. Apr. 3, 2013), the court in one part of its opinion held that Rule 8(a) applies to the pleading of 1933 Act claims unless those claims are premised on allegations of fraud, and in a later part of its opinion applied Rule 8 to the pleading of subjective falsity. No. 11-CV-2919, 2013 BL 92404, at *8 (E.D.N.Y. Apr. 3, 2013). But the court did not discuss the argument that under *Rombach* pleading subjective falsity triggers Rule 9(b).

[46] FED. R. CIV. P. 9(b).

[47] *Va. Bankshares*, 501 U.S. 1083, 1096 (1991).

[48] *Abu Dhabi Commer. Bank v. Morgan Stanley & Co.*, 888 F. Supp. 2d 431, 456–57(S.D.N.Y. 2012).

[49] *Id.* at 457.

commented that the deal was ''ridiculous,'' and expressed discomfort with ''signing off on it.''[50] That evidence also showed analysts' concern over both the ''methodology'' and the ''adequacy of the models'' used to rate the securities.[51] Similarly, in *Fed. Hous. Fin. Agency v. UBS Ams., Inc.*, 858 F. Supp. 2d 306 (S.D.N.Y. 2012), the complaint asserted that ''appraisers themselves routinely furnished appraisals that the appraisers understood were inaccurate and that they knew bore no reasonable relationship to the actual value of the underlying property.''[52] To support this claim, plaintiffs cited news stories, lawsuits, and governmental investigations that ''revealed instances in which appraisers connected to some of the mortgage originators at issue . . . were found to have systematically and knowingly overstated the value of homes in order to allow borrowers to obtain larger loans than they could afford.''[53] The complaint also alleged that the loan-to-value data reported in the offering materials ''deviate[d] so significantly from the results of plaintiff's loan-loan level analysis as to raise a plausible inference that the appraisers knowingly inflated their valuations.''[54] Thus, when pleading subjective falsity by pleading contemporaneous receipt of information contradicting the opinion, Rule 9(b) should apply.

Finally, it can be argued that requiring the pleading of subjective falsity to comply with Rule 9(b) conflicts with the 1933 Act's imposition of strict liability. But this argument is misdirected. By requiring the pleading of subjective falsity, *Fait* injected a state-of-mind requirement into what was previously thought to be a strict liability statute. The different question being considered here is, rather, whether that state-of-mind pleading requirement triggers Rule 9(b).

IV. *Fait* Extended to 1934 Act Claims

In *City of Omaha v. CBS Corp.*, 679 F.3d 64 (2d Cir. 2012), the Second Circuit extended *Fait* to 1934 Act claims.[55] Plaintiffs brought Section 10(b) and 20(a) and Rule 10b-5 claims and alleged that defendants' statements about ''CBS's goodwill and its general financial condition during the first and second quarters of 2008 were knowingly or recklessly false.'' The Second Circuit held, ''[t]hough *Fait* involved claims under Sections 11 and 12 of the Securities Act of 1933 . . . the same reasoning applies under Sections 10(a) and 20(b) of the 1934 Act, as these claims all share a material misstatement or omission element.''[56] The Second Circuit also held that, after *Fait*, pleading that defendants should have known that their statements were false or misleading is insufficient. A plaintiff must plead that defendants did not believe their statements.[57] The Second Circuit affirmed the dismissal of the complaint, in part because of plaintiffs' failure to adequately plead subjective falsity:[58] ''Plaintiffs' second amended complaint is devoid even of conclusory allegations that defendants did not believe in their statements of opinion regarding CBS's goodwill at the time they made them.'' *City of Omaha* follows in the footsteps of *Shields v. Citytrust Bancorp.*, which held that, after *Va. Bankshares*, ''[a] statement of reasons, opinion or belief . . . can be actionable under the securities laws if the speaker knows the statement to be false''[59]; *Friedman v. Mohasco Corp.*, a pre-*Va. Bankshares* case, which held that the complaint did not state a claim ''by alleging that defendants represented that securities to be issued would, in the opinion of financial advisors, have a specified market value and that the securities, when issued, did not attain the hoped for value,'' when there was no guarantee of market value and when there was no allegation that the financial advisors did not hold that opinion[60]; and *In re Time Warner Inc. Sec. Litig.*, which held that opinions, including a company's statements about its future prospects, were not actionable because plaintiffs failed to allege that defendants did not hold the opinions and that the opinions were not based in fact.[61]

V. Circuit Split

On May 23, 2013, the Sixth Circuit held, in a case involving Section 11, that ''[n]o matter the framing, once a false statement has been made, a defendant's knowledge is not relevant to a strict liability claim.''[62] Therefore, in the Sixth Circuit's view, a plaintiff need only plead objective falsity of opinions in Section 11 cases.

The Sixth Circuit rejected the Second and Ninth Circuits' reading of *Va. Bankshares*. Unlike those circuits, the Sixth Circuit characterized the Supreme Court's discussion of opinion liability as mere ''musings regarding mens rea'' and ''dicta''; read *Va. Bankshares* as not addressing whether both objective and subjective falsity are necessary for opinion liability; and concluded that ''[*Va. Bankshares*]. . . does not impact our decision today.''[63] But the Sixth Circuit's rhetoric does not fit the facts. The Supreme Court's discussion of opinion liability was carefully considered and authoritative dictum. Indeed, in *Va. Bankshares*, the U.S. Supreme Court identified opinion liability as the very first question before the Court and devoted pages of the opinion to its discussion. And the Supreme Court strongly suggested that pleading both objective and subjective falsity is required for opinion liability. The Court stated:

> The question arises, then, whether disbelief, or undisclosed belief or motivation, standing alone, should be a sufficient basis to sustain an action under § 14(a), absent proof by the sort of objective evidence described above that the statement *also* expressly or impliedly asserted something false or misleading about its subject matter. We think that proof of mere disbelief or belief undisclosed should not suffice for liability under § 14(a), and if nothing more had been re-

[50] *Id.*
[51] *Id.*
[52] *Fed. Hous. Fin. Agency v. UBS Ams., Inc.*, 858 F. Supp. 2d 306, 328 (S.D.N.Y. 2012).
[53] *Id.*
[54] *Id.*
[55] 679 F.3d 64, 67–68 (2d Cir. 2012) (Weil represented CBS in this litigation).
[56] *Id.* (citing *Fait v. Regions Fin. Corp.*, 655 F.3d at 109).
[57] *Id.* at 68–69 (''[E]ven if the second amended complaint did plausibly plead that defendants were aware of facts that should have led them to begin interim impairment testing earlier, such pleading alone would not suffice to state a securities fraud claim after *Fait*.'').
[58] *Id.* at 68.
[59] *Shields v. Citytrust Bancorp.*, 25 F.3d 1124, 1131 (2d Cir. 1994).
[60] 929 F.2d 77, 79 (2d Cir. 1991).
[61] 9 F.3d 259, 266 (2d Cir. 1993).
[62] *Ind. State Dist. Council v. Omnicare, Inc.*, 719 F.3d 498, 505 (6th Cir. 2013).
[63] *Id.* at 506.

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quired or proven in this case, we would reverse for that reason.[64]

On the same page the Court added, regarding objective falsity, ''we do not substantially narrow the cause of action by requiring a plaintiff to demonstrate something false or misleading in what the statement expressly or impliedly declared about its subject.''[65] If subjective falsity were not also required for opinion liability and if only objective falsity were required, speaking about objective falsity's not substantially narrowing the cause of action would not make sense.

In so holding, the Sixth Circuit created a circuit split. In *City of Omaha* and *Fait*, six Second Circuit judges accepted extending *Va. Bankshares* to 1933 Act claims. The Ninth Circuit also applies *Va. Bankshares* consistently with the Second Circuit.[66] And district courts in the Seventh, Tenth, and Eleventh Circuits read *Virginia Bankshares* consistently with the Second Circuit.[67]

Conclusion

Fait and like-minded courts have changed the litigation of 1933 Act claims and have provided defendants with powerful and previously unknown bases for motion practice. If the U.S. Supreme Court grants review, the stage may be set for the most important Securities Act decision in decades.

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[64] *Va. Bankshares v. Sandberg*, 501 U.S. 1083, 1095–96 (1991) (emphasis added).

[65] *Id.* at 1096.

[66] *Rubke v. Capitol Bancorp, Ltd.*, 551 F.3d 1156 (9th Cir. 2009); *see also Am. Int'l Group, Inc. v. Bank of Am. Corp. (In re Countrywide Fin. Corp. Mortgage-Backed Sec. Litig.)*, Case No. 2:11-CV-10549 MRP (MANx), slip op. at 29 (C.D. Cal. May 6, 2013) (cites *Fait* with approval).

[67] *In re JPMorgan Chase & Co. Sec. Litig.*, MDL No. 1783 - C.A. No. 06 C 46742007, 2007 BL 182057 (N.D. Ill. Dec. 18, 2007); *MHC Mut. Conversion Fund, L.P. v. United W. Bancorp, Inc.*, No. 11-cv-00624-WYD-MJW, 2012 BL 387633 (D. Colo. Dec. 19, 2012) (also cites *Fait* with approval); *Lane v. Page*, 581 F. Supp. 2d 1094 (D.N.M. 2008); *Belmont Holdings Corp. v. SunTrust Banks, Inc.*, No. 1:09-cv-1185-WSD, 2010 BL 210983 (N.D. Ga. Sept. 10, 2010) (also cites *Fait* with approval).