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US SUPREME COURT SECURITIES-FRAUD JURISPRUDENCE: AN EMERGING NEW DIRECTION?

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US SUPREME COURT
SECURITIES-FRAUD JURISPRUDENCE:
AN EMERGING NEW DIRECTION?

INTRODUCTION

This WORKING PAPER examines several key areas of securities-fraud jurisprudence that are currently under reconsideration by the US Supreme Court. Decisions the Court has issued over the past several years reflect an increasing skepticism of implied private rights of action, as well as a greater appreciation for how a lower standard for demonstrating the falsity of statements chills information sharing in the securities markets. The 2017 arrival of Justice Neil Gorsuch to the Court could accelerate this reconsideration. This paper thus discusses whether Justice Gorsuch may urge the Court to chip away at the viability of securities class actions—such as by revisiting the *Basic v. Levinson* fraud-on-the-market presumption or narrowing the meaning of scienter—and whether he may push for a return to the days of *caveat emptor* and the puffery doctrine in evaluating the falsity and materiality of statements challenged as fraudulent. It also questions whether such possible jurisprudential shifts would be in the best interest of securities-fraud defendants.

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I. CHIPPING AWAY AT SECURITIES CLASS ACTIONS?

A. Candidates for Chipping: The *Basic* Presumption and the Scienter Standard

Rule 10b–5,[1] promulgated by the US Securities and Exchange Commission (SEC) under § 10(b) of the Securities Exchange Act of 1934,[2] prohibits the making of any "untrue statement of a material fact" in connection with the purchase or sale of any security. Neither § 10(b) nor Rule 10b–5 expressly creates a private right of action.[3] Nevertheless, courts have long recognized that private plaintiffs impliedly have the right to file lawsuits alleging that they were defrauded due to Rule 10b–5 violations.[4] Often, these lawsuits take the form of class actions brought on behalf of investors who bought or sold securities during the alleged class period.

Securities class-action plaintiffs face challenges when alleging and establishing transaction causation, or reliance. Historically, plaintiffs had to prove reliance in a securities-fraud case by showing that each investor relied on the alleged misstatements in buying or selling stock. Having to prove each investor's reliance would result in individualized issues predominating over class-wide issues. In *Basic*

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[1] 17 C.F.R. 240.10b–5.

[2] 15 U.S.C. § 78j(b).

[3] *Janus Capital Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 141 (2011).

[4] *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta*, 552 U.S. 148, 164–65 (2008) (reviewing history of the implied right of action).

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Inc. v. Levinson,[5] the Court opened the door to more securities-fraud class actions by adopting the fraud-on-the-market presumption as a means of establishing causation on a class-wide basis. As the *Basic* Court explained:

> The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. ... Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements. ... The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.[6]

The Court made it easier for plaintiffs to achieve class certification by allowing them to allege reliance by invoking fraud-on-the-market, a class-wide issue. Recently, the Court reaffirmed *Basic* in *Halliburton Co. v. Erica P. John Fund, Inc.* (*Halliburton II*),[7] which held that plaintiffs may continue to invoke the fraud-on-the-market presumption in alleging causation, but that defendants could rebut this presumption by proving at the class-certification stage that the alleged misrepresentations did not impact the market price of the stock.

Although the implied right of action and the *Basic* presumption are by now well-established, they have always had their skeptics and detractors. Further, the Supreme Court today is less inclined to recognize implied rights of action than it was

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[5] 485 U.S. 224 (1988).

[6] *Id.* at 241–42 (citations and internal quotation marks omitted).

[7] 134 S. Ct. 2398 (2014).

decades ago, and has emphasized that the 10b–5 private right of action should remain limited in scope because "[t]he decision to extend the cause of action is for Congress, not for us."[8]

In *Halliburton II*, Justice Thomas—joined by Justices Scalia and Alito—concurred in the judgment but furnished a full-throated criticism of both the implied 10b–5 private right of action and the *Basic* presumption. Justice Thomas criticized the implied right of action as "a relic of the heady days in which this Court assumed common-law powers to create causes of action,"[9] and offered *Basic* as an illustration of why courts should not create a private cause of action absent express statutory authority. According to Justice Thomas, "*Basic* took an implied cause of action and grafted on a policy-driven presumption of reliance based on nascent economic theory and personal intuitions about investment behavior," resulting in an "unrecognizably broad cause of action ready made for class certification."[10]

It is too early to tell whether the Supreme Court may one day revisit the implied right of action or the *Basic* presumption, and it is perhaps unlikely that this will happen in the near future given how recently *Basic* was reaffirmed. Still, it is reasonable to presume that Justice Gorsuch—who in the past has emphasized the

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[8] *Stoneridge*, 552 U.S. at 165.

[9] *Halliburton II*, 134 S. Ct. at 2417 (Thomas, J., concurring in the judgment) (quoting *Correctional Serv. Corp. v. Malesko*, 534 U.S. 61, 75 (2001) (Scalia, J., concurring)).

[10] *Id.* at 2427.

need for courts not to exceed their authority or step into Congress's territory[11]—would be inclined to agree with the views articulated in Justice Thomas's *Halliburton II* concurrence, and that he may be skeptical of class actions in general.[12] It is possible that, during what may be a decades-long term for Justice Gorsuch, his views will become predominant on the Court.

Another candidate for chipping is the standard for proving scienter. In *Ernst & Ernst v. Hochfelder*, the Supreme Court defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud."[13] The Court has never decided whether recklessness suffices to show scienter.[14] Every federal circuit court to address the question has held that recklessness does suffice, with varying formulations on the degree of recklessness required.[15]

A scienter standard constituting actual intent to mislead investors, or something similar, would seem to be consistent with Justice Gorsuch's judicial philosophy and the Court's jurisprudence narrowly construing the private right of

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[11] *See* Amy Howe, "*Introduction: A Close Look at Judge Neil Gorsuch's Jurisprudence,*" SCOTUSBLOG (Mar. 3, 2017, 2:37 PM), http://www.scotusblog.com/2017/03/introduction-close-look-judge-neil-gorsuchs-jurisprudence/.

[12] *See id.*; *see also* Kevin LaCroix, *Supreme Court: Securities Act's Three-Year Time Limit is a Statute of Repose that Cannot be Tolled*, THE D&O DIARY (Jun. 26, 2017), http://www.dandodiary.com/2017/06/articles/securities-litigation/supreme-court-securities-acts-three-year-time-limit-statute-repose-cannot-tolled/ (observing that Justice Gorsuch is likely to be a reliable pro-business vote in class-action cases).

[13] 425 U.S. 185, 193 n.12 (1976).

[14] *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007).

[15] *Ibid.*

action under § 10(b). Yet such a standard, though legally justifiable, is not compelled by existing law—a conclusion consistent with the Court's refusal thus far to disturb the scienter standard developed by the lower courts over decades of decisions.

A free-market-oriented majority, including Justice Gorsuch, may one day make these or other changes that would limit plaintiffs' pursuit of securities class actions. The business community undoubtedly would applaud them. But, would they really be good for businesses? As the next section explains, this answer is "no."

B. Be Careful What You Wish For: The Current System Works Well

1. *Basic* Ballasts Securities Class Actions

Our current securities class-action system is straightforward and predictable. Like any other lawsuit, a securities class action starts with the filing of a complaint by a plaintiff. But after that, the procedure for these actions is unique. The Private Securities Litigation Reform Act of 1995 (Reform Act) mandates that the first plaintiff to file a securities class action must publish a press release giving notice of the lawsuit and advising class members that they can attempt to be the "lead plaintiff" by filing a motion with the court within 60 days of the press release. The Reform Act provides that the "presumptively most adequate lead plaintiff" is the one who "has the largest financial interest in the relief sought by the class" and otherwise meets the requirements of Rule 23 of the Federal Rules of Civil Procedure, which governs class actions.

The Reform Act's standards for lead plaintiff selection have caused plaintiffs' firms to pursue institutional investors as clients, since they are more likely than individual, retail investors to have the "largest financial interest" among the lead-plaintiff competitors. But in recent years, smaller plaintiffs' firms have won lead-plaintiff contests with retail investors as lead plaintiffs, primarily in securities class actions against smaller companies. Indeed, about half of all securities class actions have been filed against smaller companies by these smaller plaintiffs' firms.

This deeper and more diverse new roster of plaintiffs' firms means that securities litigation will not just go away if plaintiffs' lawyers cannot file securities cases as class actions. Securities plaintiffs' lawyers are specialized securities lawyers, and they will not stop filing lawsuits if *Basic* is abolished. They will seek out cases to file. The larger plaintiffs' firms will file actions on behalf of the institutional investors the Reform Act incentivized them to develop, while the smaller plaintiffs' firms will file claims on behalf of retail investors—the selfsame claims the Reform Act sought to replace. Together, these plaintiffs and plaintiffs' firms will fully cover the securities-litigation waterfront.

In a post-*Basic* world, non-class securities actions would be no less burdensome to defend than today's class actions, since they would involve litigation of the same core merits issues. In fact, non-class litigation would be even *more* expensive in certain respects because, for example, there would be multiple damages analyses and

case management would be vastly more complex. And if the securities class action opt-out litigation experience is indicative of the settlement value of such cases, plaintiffs would tend to settle for a larger percentage of claimed damages than plaintiffs in today's securities class actions.

In a new non-class era of securities litigation, the settlement logistics would be vastly more difficult. It's hard enough to mediate with one plaintiffs' firm and one lead plaintiff. A mediation with a dozen or more plaintiffs' firms and even more plaintiffs would be virtually unmanageable, not to mention extremely expensive. Even when settlement could be achieved, it would not preclude suits by other purchasers during the period of stock-price inflation, because there would be no due-process procedure to bind them, as when there is a certified class with notice and an opportunity to object or opt out. Indeed, a trend would likely develop of scattered follow-up suits filed by even smaller plaintiffs' firms after the larger cases have settled. There would be no peace until the expiration of the statute of limitations.[16]

Compounding this uncertainty would be the role of SEC and other government enforcement. Even if securities regulation subsides, the job of SEC personnel is to

[16] For a view of this landscape, we need look no farther than how plaintiffs adjusted to limited federal-court jurisdiction under *Morrison v. National Australia Bank*, 561 U.S. 247 (2010). *Morrison* has caused the proliferation of unbelievably expensive litigation around the world, without the ability to effectively coordinate or settle it for a reasonable amount with certain releases that are available in a U.S. securities class action. For a discussion of this phenomenon, and a recent case that illustrates it, *see* Kevin LaCroix, *The Global Rise in Collective Investor Actions*, THE D&O DIARY (Sept. 20, 2016), http://www.dandodiary.com/2016/09/articles/international-d-o/global-rise-collective-investor-actions/.

investigate and enforce the securities laws. They will not stop doing their jobs just because large-scale government regulation has been eased. In fact, SEC in all likelihood would step in to fill the void left by the inability of plaintiffs to bring private securities class actions. Experienced defense counsel can predict how plaintiffs' firms will litigate and resolve a case, but they have much less ability to predict how individual enforcement personnel (with whom defense counsel may be unfamiliar) will approach an enforcement action.

2. A Recklessness Standard Gives Defendants Greater Economic Protection and Strategic Certainty

Although securities class actions make businesspeople uncomfortable, virtually every case is manageable given the law and economics of the current system. Many securities class actions are dismissed early on under a number of applicable substantive and procedural standards, including the Reform Act, Rule 9(b), and the Supreme Court's decisions in *Omnicare*[17] and *Tellabs*.[18] Nearly all cases that survive a motion to dismiss settle before trial. Since Congress passed the Reform Act in 1995, only 16 cases have been tried to verdict.

A key reason cases settle before trial is the availability of directors and officers liability (D&O) insurance for securities class-action claims. D&O insurance covers directors and officers, and usually the company too—except where the defendant has

[17] *Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund*, 135 S. Ct. 1318 (2015).

[18] *Tellabs*, *Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007).

been found liable for fraud under a universal exclusion (dictated by public policy outlawing insurance coverage for intentional misconduct) called the fraud exclusion.

The interplay between the fraud exclusion and the substantive scienter standard greatly influences securities-litigation economics and strategy. Theoretically, a defendant can be found liable at trial under a recklessness standard without triggering the fraud exclusion because of differences in the standards—recklessness versus fraud. There is at least a sliver of daylight between the two. Since a verdict might reflect the defendant's actual fraud, which would then negate insurance coverage, settlement makes sense for the defendant, and the insurer is able to resolve a potentially covered claim for a fraction of the likely damages.

Raising the liability standard to actual fraud—coextensive with the fraud exclusion—would radically change our securities-litigation system: a liability verdict necessarily would trigger the fraud exclusion, and the defendant would incur an uninsured liability. That outcome would be bad not only for defendants, but also for their D&O insurers. A defendant who loses a motion to dismiss would place tremendous pressure on the insurer to settle claims well in advance of trial. With the knowledge that a trial verdict would be financially devastating to the defendant, plaintiffs would have tremendous settlement leverage, and settlement amounts would increase, perhaps drastically. Although insurers would face commercial and legal pressure to pay these larger settlements, just the uncertainty of the economics

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and strategy would increase the anxiety and discomfort for those who face a securities claim.

When these alternative scenarios are considered, it becomes clear that the current system works comparatively well. Justice Gorsuch may be inclined to chip away at securities class actions—but pro-business interests should think about what the world might look like without these cases before they begin cheering.

II. *OMNICARE* AND "FALSITY": A RETURN TO *CAVEAT EMPTOR* AND THE PUFFERY DOCTRINE?

In 2015, the Supreme Court issued *Omnicare,* a foundational opinion in its securities-fraud jurisprudence. *Omnicare* held that a statement of opinion is only "false" under the federal securities laws if the speaker does not genuinely believe it, and is only "misleading" if it omits information that, considered in its full context, would cause the statement to mislead a reasonable investor.

Omnicare is the most significant post-Reform Act Supreme Court case to analyze the falsity element of a securities class-action claim, laying out the core principles of falsity in the same way that the Court did for scienter in *Tellabs*. As such, the case functions as a roadmap for how to defend allegations of falsity effectively, touching on multiple strategic and legal elements of a strong defense. It is a powerful addition to the defense bar's toolkit, and is already having a positive impact on lower

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courts' analysis of opinion statements in securities class actions.[19]

Will Justice Gorsuch push for change in this area of the law, or will he embrace *Omnicare* as a sound decision? A 2014 opinion he authored as a judge on the US Court of Appeals for the Tenth Circuit may offer some clues. *MHC Mutual Conversion Fund, L.P. v. Sandler O'Neill & Partners, L.P.*[20] was a pre-*Omnicare* case addressing securities-fraud liability for opinion statements. This case reflects not only Justice Gorsuch's preferred approach to evaluating statements of opinion, but his view of how to interpret and apply the federal securities laws as a whole.

A. The *Omnicare* Decision

The primary question addressed by the *Omnicare* Court was: Under what circumstances does a statement of opinion constitute an "untrue statement of … fact" or a "misleading" statement for purposes of § 11 of the Securities Act of 1933?[21]

The Supreme Court held that first, an opinion is *false* only if the speaker did not sincerely believed it at the time that the opinion was expressed,[22] a concept

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[19] *See* Douglas W. Greene and Claire Loebs Davis, Omnicare, Inc., *One Year Later: Its Salutary Impact on Securities-Fraud Class Actions in the Lower Federal Courts*, Washington Legal Foundation: WORKING PAPER, No. 195 (Jun. 2016), http://www.wlf.org/upload/legalstudies/workingpaper/GreeneDavisWP.pdf.

[20] 761 F.3d 1109 (10th Cir. 2014).

[21] Section 11 governs registration statements filed by issuers of securities. Lower courts have subsequently applied the *Omnicare* standard to the securities laws generally, including to cases brought under § 10(b) of the Securities Exchange Act of 1934. *See, e.g.*, *Tongue v. Sanofi*, 816 F.3d 199 (2d Cir. 2016); *City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech., Inc.*, 856 F.3d 605 (9th Cir. 2017).

[22] *Omnicare*, 135 S. Ct. at 1327.

sometimes referred to as "subjective falsity."[23] The Court thus explicitly rejected the possibility that a statement of opinion could be false because "external facts show the opinion to be incorrect," because a company failed to "disclose[] some fact cutting the other way," or because the company did not disclose that others disagreed with its opinion.[24] This ruling resolved the confusing muddle of conflicting standards previously applied by the circuit courts concerning what makes a statement of opinion "false."

Second, *Omnicare* declared that whether a statement of opinion is *misleading* "always depends on context."[25] The Court emphasized that, in evaluating whether an opinion statement is "misleading," courts must consider not only the full statement being challenged and the context in which it was made, but also other statements made by the company and other publicly available information, including the customs and practices of the relevant industry.

The Court explained in detail, using hypothetical examples, how this standard applies to statements of opinion, making clear that an opinion statement is "not necessarily misleading when an issuer knows, but fails to disclose, some fact cutting

[23] *See, e.g.*, *Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1162 (9th Cir. 2009) (citing *Va. Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1095-96 (1991)).

[24] *Omnicare*, 135 S. Ct. at 1328-29.

[25] *Id*. at 1330.

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the other way."[26] For instance, the Court said, the statement "We believe our conduct is lawful" would not be misleading if some of the company's lawyers had approved the conduct but one had expressed doubts.[27]

The Court emphasized that whether a statement is misleading "always depends on context," because a statement must be understood in its "broader frame," including "in light of all its surrounding text, including hedges, disclaimers, and apparently conflicting information," as well as the "customs and practices of the relevant industry."[28] Emphasizing that pleading the existence of a misleading opinion is "no small task" for plaintiffs, the Court then described the variety of contextual weapons that defense attorneys can use to fight against allegations that a statement of opinion—or any kind of statement—was misleading due to omission.[29]

This ruling is beneficial from the defense perspective because it mandates that a contextual analysis is necessary not only to determine the existence of scienter (as the Court had previously held in *Tellabs*), but also to judge whether a statement can be viewed as misleading. Evaluating challenged statements in their broader context almost always benefits defendants, because it helps the court better understand the challenged statements and makes them seem fairer than they might in isolation.

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[26] *Id*. at 1329.

[27] *Ibid.*

[28] *Id.* at 1330.

[29] *Id.* at 1332.

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Since the *Omnicare* decision came down, lower courts' application of it has generally underscored its importance as a useful tool for defendants.[30]

B. Clues from the *MHC Mutual Conversion Fund* Case

About six months before the *Omnicare* decision came down, then-Judge Gorsuch authored the Tenth Circuit's opinion in *MHC Mutual Conversion Fund*. The case, like *Omnicare*, considered when an opinion statement is false or misleading for purposes of § 11. The opinion in *MHC* provides a glimpse into Justice Gorsuch's thinking about this issue in particular and about the interpretation and application of the securities laws in general.

MHC identifies three potential frameworks for assessing whether statements of opinion create liability under the securities laws: (1) a *caveat emptor* approach, which essentially treats statements of opinion as mere puffery; (2) an approach that requires a statement to be both subjectively and objectively false in order to be actionable; and (3) an approach that creates liability for certain opinion statements that lack a "reasonable basis."

1. "*Caveat Emptor*": Opinion Statements as Puffery

Justice Gorsuch's jurisprudential philosophy is on display in *MHC*'s discussion of the *caveat emptor* approach. *MHC* notes that, at the time Congress passed the Securities Act of 1933, "many common law authorities took a dim view of opinion

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[30] *See* Greene and Davis, *supra* note 21.

liability."[31] Under this framework, even if the statement at issue was subjectively false (*i.e.*, if the speaker did not believe the statement of his own purported opinion), it would not be actionable because "the law at the time looked dubiously on liability for failed opinions less because opinions fail to convey a statement of fact and more because any seller's opinion should be thought immaterial by a buyer or not the sort of thing a buyer might justifiably rely upon."[32] This section of the opinion also cites the writings of Oliver Wendell Holmes, Jr. and of scholars who embraced similar views contemporaneously with the passage of the 1933 Act.[33]

MHC's lengthy discussion of *caveat emptor*, along with the fact that the analysis is consistent with the originalist legal thinking for which Justice Gorsuch is known, suggests that this may be his preferred approach to thinking about statements of opinion. He begins the *MHC* opinion by discussing the historical understanding that statements of opinion are mere "puffery" by nature (a theme to which he returns several times throughout *MHC*) and offers little criticism of an approach that essentially precludes liability for opinion statements. Still—perhaps in recognition that this reasoning was unlikely to be adopted ultimately as the controlling standard—Judge Gorsuch went on to discuss two other common, pre-*Omnicare* approaches to evaluating opinion statements.

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[31] *MHC*, 761 F.3d at 1112.

[32] *Ibid.*

[33] *See id.* at 1112–13.

2. Subjective and Objective Falsity

The second approach discussed in *MHC* is one that examines the subjective and objective falsity of the opinion statement. Subjective falsity refers to the speaker's belief in what he is saying: "an opinion can qualify as a factual claim by the speaker regarding his current state of mind;" *i.e.*, "that *he believes something*."[34] Objective falsity means the opinion is inconsistent with what turns out to be the truth (it "didn't prove out in the end").[35]

Just as it does in discussing *caveat emptor* and the puffery doctrine, the *MHC* opinion puts an originalist spin on its discussion of subjective falsity, noting that "by 1933 … at least some common law courts had embraced just this notion, accepting that a statement about one's beliefs could give rise to a claim for misrepresentation in at least some circumstances."[36] The opinion also acknowledges that this understanding of how an opinion can be false was articulated by the Supreme Court in *Virginia Bankshares* in 1991.[37]

The subjective/objective framework as articulated in *MHC* emphasizes that opinion statements about future events that "fail to pan out" cannot be deemed false in hindsight. Although such "objectively false" opinions are not actually "false"

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[34] *Id.* at 1113 (emphasis original).

[35] *Ibid.*

[36] *Ibid.*

[37] *Id.* at 1113–14 (citing *Va. Bankshares*, 501 U.S. 1083, 1097 (1991); *id.* at 1108–09 (Scalia, J., concurring)).

according to *MHC*, they may help demonstrate the *materiality* of an opinion statement.[38] Thus, *MHC* states that under the subjective/objective framework, an opinion statement may be actionable if it is *both* subjectively false (*i.e.*, the opinion was not the speaker's real opinion) *and* objectively false (*i.e.*, it "didn't prove out in the end").[39]

In describing statements as "objectively false" when they are material but *not* false, *MHC* conflated the concepts of falsity on the one hand and materiality on the other. By contrast, the Supreme Court in *Omnicare* clearly delineated these two concepts, resolving much of the confusion that had plagued the lower courts. The conflation of these separate concepts raises the specter of similar errors with perhaps more serious consequences, such as the conflation of falsity with scienter in the Sixth Circuit's overturned ruling in *Omnicare*.[40] *Omnicare* eschews any discussion of the confusing concept of "objective falsity," holding that an opinion can only be "false" if it is *subjectively* false, but like any other statement, may still be "misleading" to a reasonable investor when considered in context.

3. Reasonable Basis as to Expert Opinions

The third and final approach discussed in *MHC* applies only to "fiduciaries and

[38] *Id.* at 1113.

[39] *Id.* at 1114 (citing authority from the Second, Ninth, Fourth, Fifth, and Sixth Circuits).

[40] *See* Brief of Washington Legal Foundation as *Amicus Curiae* at 21–22, 29–32, *Omnicare, Inc.*, http://www.wlf.org/upload/litigation/briefs/OmnicarevLaborers-WLFAmicus.pdf.

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those who hold themselves out as experts," and posits that opinions expressed by such persons may "contain within them an implicit factual warranty that they rest on an objectively reasonable basis" that can ground a common-law claim for negligent misrepresentation.[41]

Based on the *MHC* opinion, Justice Gorsuch seems appropriately skeptical of the notion that "lack of reasonable basis" can be a ground for finding liability for an opinion statement (and indeed, the Supreme Court in *Omnicare* ultimately rejected this notion). *MHC* notes that other courts have questioned whether the "reasonable basis" approach is consistent with the Supreme Court's ruling in *Virginia Bankshares* (which required a showing of subjective falsity) and whether it is consistent with the statutory text and history of the Securities Act of 1933 (which, the *MHC* opinion notes, "doesn't speak of implications imposed by law").[42] *MHC* also applied an originalist analysis in questioning whether securities issuers ought to be saddled with fiduciary obligations, noting that "some early commentators and the SEC itself for some time at least seemed to conceive of issuers more like sellers of goods whose crystal balls are thought no better than anyone else's."[43]

Although *Omnicare* ultimately rejected the "reasonable basis" test (which may be gone for good as a result), Justice Gorsuch's analysis of this test in *MHC*

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[41] *MHC*, 761 F.3d at 1115–16.

[42] *Id.* at 1116.

[43] *Id.* at 1117.

nevertheless provides some valuable insight into the way he thinks about the securities laws. It illustrates that his approach is generally guided by textualism (*i.e.*, what the 1933 Act does and does not "speak of"), originalism (*i.e.*, what courts, commentators, and SEC generally understood at the time the 1933 Act was passed), or both. By contrast, the *Omnicare* Court, in evaluating the circumstances under which a statement of opinion is "misleading," focused more on the existing body of securities case law and drew on the common-law conception of misrepresentation as articulated in the Restatement (Second) of Torts. Based on this authority and analysis, the *Omnicare* Court arrived at its "objective" test for whether an opinion is misleading: whether, taken in its full context, the statement of opinion would mislead a reasonable investor.[44]

The Tenth Circuit did not decide in *MHC* which of the above three tests was the correct one (though, as noted above, it criticized the "reasonable basis" test and seemed to favor the "*caveat emptor*" approach). Instead, the court assumed for purposes of its opinion that "the objectively reasonable basis test is at least an available (if not an exclusive) one," and found that plaintiffs' complaint failed even this most plaintiff-friendly test.[45]

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[44] *Omnicare*, 135 S. Ct. at 1327.

[45] *MHC*, 761 F.3d at 1117. In an odd twist of fate, this portion of the *MHC* opinion relied in part on a case involving the man who would ultimately appoint Justice Gorsuch to the Supreme Court. *See id.* at 1119 (citing *Donald J. Trump Casino Sec. Litig.*, 7 F.3d 357 (3d Cir. 1993) for the proposition

B. Will Justice Gorsuch Embrace *Omnicare*?

The *MHC* opinion suggests that Justice Gorsuch's preferred approach may be a return to the days of *caveat emptor* and the puffery doctrine. This is at least superficially a pro-business stance—but, as several commentators have observed, the puffery doctrine is in fact harmful to both issuers and investors because it is both overinclusive and underinclusive.

Puffery is overinclusive, and thus overprotective, because it gives investors the troubling message that companies may lie with impunity, as long as they couch their statements in subjective terms.[46] At the same time, because it does not apply any consistent standard, puffery is underinclusive, and thus underprotective. Corporate actors are unable to predict whether their opinions will be virtually immunized as puffery, or possibly subjected to liability under a standard that ignores whether they were honestly held. As a result, puffery is not a principled standard of liability on which either companies or investors can depend.[47] Furthermore, the puffery doctrine is at odds with longstanding Supreme Court precedent recognizing that there is "no

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that statements in a prospectus are not misleading when accompanied by adequate cautionary language).

[46] *See* Jennifer O'Hare, *The Resurrection of the Dodo: The Unfortunate Re-Emergence of the Puffery Doctrine in Private Securities Fraud Actions*, 59 OHIO ST. L. J. 1697, 1715-16, 1725-26 (1998) (explaining that puffery is based on the doctrine of *caveat emptor*, which is outdated and at odds with the fundamental objectives of the securities laws).

[47] *See* Wendy G. Couture, *Opinions Actionable as Securities Fraud*, 73 LA. L. REV. 381, 411 (2013) ("A uniform and predictable test is imperative so that corporate actors are not afraid to speak, lest they inadvertently subject themselves to liability.").

serious question" that statements of opinion can be material.[48]

Justice Gorsuch may not agree, however. The *MHC* opinion questioned the notion that a subjectively true opinion statement can *ever* be misleading: "How is an opinion false *or misleading* so long as it's earnestly held, even if supported by evidence sufficient to persuade only the speaker?"[49] This blunt approach essentially reads the "misleading" prong out of the "false or misleading statement" element of § 11 and § 10(b), and furthermore disregards the reality that opinion statements come in many shapes and forms—from subjective judgments to conveyance of embedded facts to predictions and risk evaluations—and are capable of genuinely misleading investors.[50]

Still, the *MHC* opinion did not consider a standard along the lines of what the Supreme Court adopted the following year in *Omnicare*. Perhaps Justice Gorsuch has or will come around to the *Omnicare* Court's view that statements of opinion can be actionably misleading if they would mislead a reasonable investor. Notably, Justice Scalia—who is widely viewed as Justice Gorsuch's intellectual guiding light[51]—concurred in the *Omnicare* opinion, agreeing with its holding that "an expression of opinion implies facts … where a reasonable listener would understand it to do so,"

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[48] *Va. Bankshares*, 501 U.S. at 1090–91.

[49] *MHC*, 761 F.3d at 1116 (emphasis added).

[50] *See* Brief of Washington Legal Foundation as *Amicus Curiae*, *supra* note 40, at 7–10, 27–29.

[51] *See* Howe, *supra* note 11.

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and that such opinions can be misleading by omission.[52] Rather than take issue with this framework, Justice Scalia disagreed with the Court's application of it to statements about legal compliance, opining that such statements do not convey to a reasonable investor that the company has consulted with an attorney.[53]

A return to the outdated *caveat emptor* doctrine would benefit no one. It would reintroduce confusion and inconsistency into courts' analysis of opinion statements, and would harm both issuers and investors in the process. By contrast, *Omnicare* established a clear, practical, and just framework for analyzing opinion statements. Justice Gorsuch would do well to embrace this precedent.

CONCLUSION

Justice Gorsuch alone will not effect immediate, radical change on the Supreme Court. Nevertheless, much like his predecessor Justice Scalia, he is poised to be a thought leader. If his jurisprudential approach comes to predominate, the securities-litigation landscape could look vastly different from the way it does today—though not necessarily for the better.

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[52] *Omnicare*, 135 S. Ct. at 1334 (Scalia, J., concurring).

[53] *Id.* at 1335.

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