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Recent Second Circuit Decision in *Kaess* v. *Deutsche Bank* Underscores Significance of Anticipated Ruling by U.S. Supreme Court Next Term in *Omnicare* on Liability for Statements of Opinion

In *Kaess* v. *Deutsche Bank AG*, No. 13-2364 (2d Cir. July 16, 2014), the Second Circuit applied the reasoning in its 2011 decision in *Fait* v. *Regions Financial Corporation*, 655 F.3d 105 (2d Cir. 2011), to hold that Deutsche Bank's alleged misstatements concerning trading exposure to certain mortgage-backed securities were statements of opinion that could be actionable only if pleaded to be *both* objectively and subjectively false. The Court thus affirmed by summary order the dismissal of plaintiffs' claims under the Securities Act of 1933. The *Kaess* decision again demonstrates the divergence between the circuits on the question of whether a statement of opinion is actionable under the non-scienter-based provisions of the securities laws absent a showing of subjective falsity. The Supreme Court will address this issue next term in *Omnicare, Inc.* v. *Laborers District Council Construction Industry Pension Fund*, No. 13-435.

Background

The *Kaess* case arises from a series of securities offerings made pursuant to a shelf registration statement and prospectus supplements filed by Deutsche Bank between 2006 and 2008. Plaintiffs argued that a number of statements in the offering materials were misleading, giving rise to liability under Sections 11, 12(a)(2) and 15 of the Securities Act of 1933. In particular, plaintiffs claimed that Deutsche Bank had misstated the extent of its investment in and exposure to residential mortgage-backed securities ("RMBS") based on "subjective" internal estimates that were "clearly inconsistent with actual current market conditions." Plaintiffs also alleged that Deutsche Bank misstated its value-at-risk ("VaR") metrics, noting that certain of the offering materials estimated its 2007 equities trading VaR in a range of $43.5 to $90.5 million—significantly less than the recorded equities trading losses of $630 million in 2008.

In August 2011, the United States District Court for the Southern District of New York (Batts, J.) granted in part and denied in part defendants' motion to dismiss. Of relevance, Judge Batts denied defendants' motion to dismiss Securities Act claims concerning exposure to RMBS and VaR metrics.

Four days later, however, the Second Circuit issued its opinion in *Fait*, which held that, when liability under Section 11 or 12 of the Securities Act of 1933 is "based upon a belief or opinion alleged to have been communicated by a defendant, liability lies only to the extent that the statement was both objectively false

and disbelieved by the defendant at the time it was expressed." *Fait*, 655 F.3d at 110. Relying on this principle, the Second Circuit in *Fait* affirmed dismissal of claims brought under the Securities Act that were based on statements about goodwill and loan loss reserves because plaintiffs had failed to allege that defendants did not honestly believe the statements at the time they were made.

Following *Fait*, Deutsche Bank filed a motion for reconsideration, which the District Court granted in August 2012. Relying on *Fait*, Judge Batts held that defendants' statements about RMBS exposure and VaR metrics were statements of valuation that were "matter[s] of opinion rather than fact," and that plaintiffs had failed to allege that "[d]efendants did not honestly believe those valuations when made."

Second Circuit Summary Order

The Second Circuit affirmed the District Court order dismissing plaintiffs' claims under *Fait*. In a summary order, the Second Circuit found that "the district court was correct to hold that [Deutsche Bank's] estimation of the extent of its investment in and exposure to residential mortgage-backed securities, as well as its statements about its Value-at-Risk . . . metrics, amounted only to statements of opinion." Relying on *Fait*, the Second Circuit thus held that plaintiffs' claims based on these statements failed because plaintiffs' complaint contained no allegations that Deutsche Bank "disbelieved its own disclosures about credit trading, market risk and its exposure to the subprime and nonprime markets, or its own VaR metrics and internal valuation models."

Analysis

The Second Circuit decision in *Kaess* is a natural extension of *Fait*—which involved accounting judgments relating to goodwill and loan loss reserves under GAAP—to other types of valuation models estimating exposure and market risk. The decision both confirms and expands Second Circuit law on the application of *Fait*'s holding to statements of opinion, projections and estimates.

Both *Fait* and *Kaess* begin, however, with a legal question that was first presented to the Supreme Court in 1991 in *Virginia Bankshares, Inc.* v. *Sandberg*, 501 U.S. 1083 (1991): When, if at all, is so-called "soft" information, such as statements of reasons, opinions, or beliefs, actionable as a statement "with respect to material facts" under the federal securities laws? In *Virginia Bankshares*, the Supreme Court held that such a statement can be actionable if it constitutes "a misstatement of the psychological fact of the speaker's belief in what he says." 501 U.S. at 1095. In the wake of *Virginia Bankshares*, the Courts of Appeals in the Second, Third, and Ninth Circuits have thus required plaintiffs to plead and prove that statements of belief are actionable only if they are *both* subjectively and objectively false.

The Sixth Circuit, on the other hand, has recently taken a different view. In *Indiana State District Council of Laborers and HOD Carriers Pension and Welfare Fund* v. *Omnicare, Inc.*, 719 F.3d 498 (6th Cir. 2013), the Sixth Circuit held that for non-scienter-based Securities Act claims, plaintiffs are required to allege only that a statement of opinion was *objectively* false at the time it was made. The Sixth Circuit rejected the Second Circuit's approach in *Fait,* reasoning that, by requiring proof of subjective falsity, the ruling improperly imputes a scienter requirement into a cause of action that would not otherwise require scienter. 719 F.3d at 507-08.

The Supreme Court has granted a petition for a writ of certiorari in *Omnicare*, and is anticipated to address this circuit split next term. *Omnicare, Inc.* v. *Laborers District Council Construction Industry Pension Fund*, No. 13-435. As framed in the cert petition, the Supreme Court will address whether, for purposes of a claim under Section 11 of the Securities Act, a plaintiff may "plead that a statement of opinion was 'untrue' merely by alleging that the opinion itself was objectively wrong, as the Sixth Circuit has concluded, or must . . . also allege that the statement was subjectively false—requiring allegations that the speaker's actual opinion was different from the one expressed—as the Second, Third, and Ninth Circuits have held." This ruling may well have significant implications, particularly for companies that routinely report "soft" financial information, such as forecasts and estimates.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Charles E. Davidow
202-223-7380
cdavidow@paulweiss.com

Audra J. Soloway
212-373-3289
asoloway@paulweiss.com

Associate Andree J. Goldsmith contributed to this client alert.