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Litigation

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SECOND CIRCUIT HOLDS THAT STATEMENTS OF OPINION ARE NOT ACTIONABLE UNDER STRICT LIABILITY PROVISIONS OF SECURITIES LAWS UNLESS PLAINTIFFS ALLEGE THAT THE SPEAKER DID NOT BELIEVE THOSE OPINIONS

On August 23, 2011, the United States Court of Appeals for the Second Circuit affirmed the dismissal with prejudice of the securities class action in *Fait v. Regions Financial Corporation, et al.* The Second Circuit held that (i) the statements at issue about amounts of goodwill and loan loss reserves were statements of opinion rather than objective fact and (ii) plaintiff's failure to allege that the defendants did not believe their statements about goodwill and loan loss reserves when they were made was fatal to the complaint even though the complaint only asserted claims under the Securities Act of 1933, which generally does not require a plaintiff to plead that statements were made with a particular mental state.

In November 2006, Regions Financial Corporation (a bank holding company) acquired AmSouth Bancorporation (another bank holding company) in a transaction valued at approximately \$10 billion. In connection with the acquisition, Regions recorded approximately \$6.5 billion in goodwill. In April 2008, a wholly-owned subsidiary of Regions issued the trust preferred securities that were at issue in *Fait*.

In early 2009, Regions issued its fourth quarter 2008 financial results, reporting that it was writing down \$6 billion of goodwill and increasing loan loss reserves to \$1.15 billion. Plaintiff filed claims under the '33 Act against Regions, the directors who signed the registration statement for the trust preferred securities, the underwriters, and Regions' auditor, alleging that the 2009 adjustment showed that the offering documents for the trust preferred securities were false and misleading when issued. Plaintiff pointed to the severe market turmoil in 2007 and 2008 and asserted that the bank failures, mortgage company failures, and government bailouts should have led Regions to adjust goodwill and loan loss reserves much more and much earlier. Plaintiff alleged in essence that Regions had overstated its goodwill and understated its loan loss reserves. Critically, plaintiff expressly disclaimed any allegation of fraud or intentional or reckless misconduct.

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All of the defendants moved to dismiss the complaint, arguing that plaintiff failed to allege that any statement was misleading at the time it was made and failed to establish that any such misrepresentation was material in any regard. The District Court concluded that the challenged statements “were ones of judgment and opinion, rather than fact” and granted the motions to dismiss as against all parties with prejudice, and the plaintiff appealed to the United States Court of Appeals for the Second Circuit.

The Second Circuit affirmed the dismissal. The Second Circuit began by noting that claims under Sections 11 and 12 of the '33 Act, unlike claims brought pursuant to Section 10(b) of the Securities Exchange Act of 1934, generally do not require allegations that the speaker had a particular mental state with respect to the challenged statement. But the Second Circuit then explained that when a plaintiff asserts a claim under Sections 11 or 12 based on a disclosure about a belief or an opinion, the defendant will only be liable if the statement of belief or opinion was *both* objectively false *and* disbelieved by the defendant at the time it was made. The Second Circuit agreed that Regions' statements about goodwill were opinions rather than material fact because estimates of goodwill “depend on management's determination of the ‘fair value’ of the assets acquired and liabilities assumed, which are not matters of objective fact.” The Second Circuit reached a similar conclusion regarding Regions' statements regarding its loan loss reserves. Because plaintiff argued that Regions should have reached different conclusions about its goodwill and loan loss reserve amounts but never alleged that Regions' management did not believe the statements Regions made regarding goodwill or loan loss reserves (in fact, plaintiff clearly and repeatedly disclaimed that it was even trying to plead fraud or intentional or reckless misconduct), the Second Circuit agreed that plaintiff failed to allege any actionable misstatements about goodwill or loan loss reserves.

This decision is important for defendants because it means that certain types of statements in offering documents that are inherently statements of opinion may no longer be subject to claims under the '33 Act without pleading that the makers of the statements actually disbelieved them; plaintiffs' lawyers often characterize claims like those in the *Fait* case as strict liability claims for the issuer and only subject to affirmative defenses for certain directors, underwriters, and auditors, and plaintiffs' lawyers often favor '33 Act claims over '34 Act claims in certain situations. But because plaintiffs' lawyers often plead '33 Act claims to avoid the requirement of pleading what the speaker knew or believed in the first instance (because it is subject to a higher pleading standard), this decision could have a significant impact on the way certain types of securities claims are asserted and may cause plaintiffs' lawyers to plead claims differently.

Milbank represented underwriters UBS Securities LLC, Citigroup Global Markets Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Wachovia Capital Markets, LLC, Morgan Stanley & Co. LLC f/k/a Morgan Stanley & Co., Incorporated, and Morgan Keegan & Company, Inc. before the District Court and Second Circuit.

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