Federal Judge Reconsiders Securities Claims Against GE And Identifies Three Categories Of Statements That Are Not Actionable Under Federal Securities Laws

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In a consolidated class action in the Manhattan federal court, General Electric and more than 40 other defendants, including CEO Jeffrey Immelt, CFO Keith Sherin, other officers, directors and various underwriters are accused of violating the Securities Act of 1933 and the Exchange Act of 1934 by making false and misleading statements about GE's business – such as its ability to sell commercial paper and the value of its loan portfolio – during the recent financial crisis and, specifically, in offering documents for GE's secondary public offering in October 2008.

Last month, Judge Denise Cote reconsidered a prior ruling by Judge Richard Holwell (who has since retired) about which claims the plaintiffs may pursue. Her decision offers important lessons about certain types of statements that are not actionable under federal securities law.

Unincorporated Statements Are Not Actionable

The plaintiffs allege that, during the financial crisis, GE made false and misleading statements about the strong demand for its commercial paper. While that may be so, for the purpose of assessing federal statutory liability, Judge Cote closely examined GE's offering documents and concluded that those specific statements were made only in GE's September 2008 press release, not its October 2008 prospectus. This is because the press release that contained the challenged statements was attached to a Form 8-K, but the offering documents incorporated only Item 8.01 of that Form 8 K, not the entire filing -- and not the press release in particular.

Thus, upon reconsideration, Judge Cote ruled that, in allowing the 1933 Act claim to proceed, Judge Holwell should not have relied on Immelt's unincorporated statements in GE's press release that "demand remains strong for GE Capital's commercial paper" and that "GE's funding position remains strong."

LESSON ONE: Issuers must carefully review and fully understand all of the documents that are included in their offering materials, including those documents that are incorporated by reference, because any incorporated statements may expose issuers to later suit if those statements turn out to be false.

Further, if issuers do face 1933 Act claims, they should closely examine the relevant documents (e.g., the registration statement or prospectus) to determine if the allegedly false statements were, in fact, incorporated. If not, the claim should be dismissed.

Superseded Statements Are Not Actionable

The plaintiffs also claim that GE made false and misleading statements that the commercial paper market was, and would likely remain, a "reliable source of short-term financing." These statements were made in various filings, including GE's annual reports, dating back to 2004, which were fully incorporated in GE's offering documents. Yet these particular statements had been made years earlier, long before the financial crisis, and they had been "directly modified" by later statements. Citing SEC Rule 412(a), Judge Cote ruled that Judge Holwell should not have considered these superseded statements in allowing any 1933 Act claim to go forward.

LESSON TWO: The duty to update public statements is meaningful, and issuers should "cure" prior misstatements (or omissions) to avoid liability under the 1933 Act.

Although correcting prior statements will not immunize issuers from all liability, it may cut short class periods, thereby limiting potential exposure to those periods before corrective statements were made.

Opinion Statements Are Not Actionable Unless "Objectively and Subjectively False"

Finally, the plaintiffs claim that, in connection with GE's offering, Immelt falsely asserted that, despite "the recent market volatility, we continue to successfully meet our commercial paper needs." Judge Cote ruled (1) this statement was "a statement of opinion, not objective fact," and (2) in their complaint, the plaintiffs fail to allege that Immelt subjectively disbelieved his own statement.

Judge Cote did not explain her "opinion, not fact" conclusion. Her second ruling, however, reflected the principle that, to be actionable, a statement of opinion must be subjectively false. In *Fait v. Regions Financial Corp.*, 655 F.3d 105, 110 (2d Cir. 2011), which was decided a few months before Judge Howell issued his decision, the Second Circuit affirmed the dismissal of 1933 Act claims, ruling "[l]iability lies only to the extent that the statement was both objectively false and disbelieved by the defendant at the time it was made." With that principle in mind, Judge Cote searched plaintiffs' pleading and found no allegation that Immelt disbelieved his own statements. If the plaintiffs had properly alleged that Immelt misrepresented his own belief, their claim might well have survived. The plaintiffs have since asked for leave to amend their complaint to add that very allegation.

The related ruling by Judge Cote that the plaintiffs may proceed with their 1934 Act claim based on Sherin's allegedly false and misleading statements concerning the quality of GE Capital's loan portfolio – that it was "great," "robust" and "very high quality" notwithstanding the financial crisis – provides a useful counter-example of the critical concept of "subjective falsity." Although these statements were "prototypical opinion statements," Judge Cote found that the plaintiffs adequately pled that Sherin did not believe his own assertions when he made them. Pointing to the plaintiffs' scienter pleadings, she noted "the plethora of reports" about GE Capital's assets and concluded it was "highly implausible" that Sherin was "ignorant of the basic facts contained in these reports."

LESSON THREE: In assessing federal securities claims under the 1933 or 1934 Act, the alleged false statements should be carefully considered to determine whether they assert facts or express opinions, and if only the latter, the pleading should be closely examined to see whether it also alleges that opinions were "subjectively false."

If not, the claims will fail, even under the 1933 Act which does not require plaintiffs to prove scienter and imposes liability for "mere negligence" in making false statements.

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