No. 22-1165

In The
Supreme Court of the United States

MACQUARIE INFRASTRUCTURE CORPORATION ET AL.,
Petitioners,
v.

MOAB PARTNERS, L.P., ET AL.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether the Second Circuit erred in holding—in conflict with decisions of the Third, Ninth, and Eleventh Circuits—that a failure to make a disclosure required under Item 303 of SEC Regulation S-K can support a private claim under § 10(b) of the Securities Exchange Act, even in the absence of an otherwise-misleading statement.

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INTEREST OF *AMICUS CURIAE*[1]

Washington Legal Foundation (WLF) is a non-profit, public-interest law firm and policy center with supporters nationwide. Founded in 1977, WLF promotes free enterprise, individual rights, limited government, and the rule of law.

To that end, WLF often appears as an *amicus curiae* before this Court in key cases raising the proper scope of the federal securities laws. *See*, *e.g.*, *Goldman Sachs Grp., Inc. v. Ark. Teacher Ret. Sys.*, 141 S. Ct. 1951 (2021); *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175 (2015). And WLF's Legal Studies Division routinely publishes papers by outside experts on federal securities law.

WLF files this brief to promote the interests of investors seeking useful information about companies for potential investment purposes and shareholders who suffer when the companies in which they own shares face outsized and unwarranted liability under the federal securities laws. WLF believes that the Second Circuit has wrongly expanded liability under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, and Rule 10b–5, 17 C.F.R. § 240.10b–5(b).

SUMMARY OF ARGUMENT

Moab advocates a broad expansion of the implied private right of action under Section 10(b)

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[1] Under Rule 37.6 of the Rules of this Court, the undersigned state that no counsel for Petitioner or Respondents authored any part of this brief, and no person other than amicus curiae or its counsel made any monetary contribution to the preparation or submission of this brief.

and Rule 10b–5. This expansion is at odds with (i) the plain meaning of Rule 10b–5(b), (ii) the common-law fraud principles that are reflected in Rule 10b–5, and (iii) this Court's case law on Section 10(b). Moreover, Moab's position poses significant public policy concerns because it would create an unwarranted litigation burden on companies and the courts.

First, the Second Circuit misapplied Rule 10b–5(b)—and the "half-truth" fraud principles reflected in it—to hold that a failure to make a required Item 303 disclosure is an omission that by itself can support a violation of Section 10(b) and Rule 10b–5. *See* Pet. App. 6a (citing *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 101 (2d Cir. 2015)). Rule 10b–5(b) provides that an omission is actionable where it makes an affirmative statement misleading. This rule does not, and cannot, support a finding that the failure to make disclosures of trends or uncertainties under Item 303 is actionable when no specific, identified statement is alleged to be misleading because of the omission. Notwithstanding the Second Circuit's reference to Rule 10b–5(b), the Second Circuit in effect would allow Moab to bring its claim based on a "pure omission" fraud theory instead of a half-truth fraud theory.

Second, permitting a pure omission fraud theory here would run afoul of not only the plain meaning of Rule 10b–5(b), but also traditional common-law fraud principles, which have informed this Court's Rule 10b–5 and Section 10 jurisprudence. Consistent with common-law principles embodied in the Restatement (Second) of Torts Section 551, the Court has recognized an actionable fraudulent omission only under Section 10b–5(a) and (c), and

even then, only where at least two threshold conditions are met (along with the other prerequisites for liability under those subsections). The first of those conditions is the existence of a fiduciary relationship, and the second is a transaction to which the defendant was a party and in which he participated for personal gain. Neither condition is satisfied by an issuer's mere omission, in its periodic financial disclosures, of information under Item 303.

Finally, the Second Circuit's approach is not only unlawful, but also counterproductive. Adopting the Second Circuit's holding would lead to a deluge of unnecessary corporate disclosures, which the SEC has discouraged as unhelpful for shareholders. This would undermine Item 303's purpose and the SEC's carefully balanced framework for ensuring the flow of useful information to investors. It also would lead to increased and protracted securities-fraud litigation, which will harm companies and deplete already strained judicial resources.

In sum, the Second Circuit's flawed reasoning leads to the wrong result. Under this Court's precedent, failing to comply with Item 303 is not an independent basis for Section 10(b) or Rule 10b–5 liability. Ruling otherwise would greatly expand the implied private right of action beyond anything contemplated by Congress or the courts. Such a holding would harm shareholders, companies, and the courts.

ARGUMENT

I. THE SECOND CIRCUIT'S HOLDING MISAPPLIES RULE 10b–5(b) AND THE COMMON-LAW PRINCIPLES OF HALF-TRUTH FRAUD UNDERLYING IT

The Second Circuit held that omitting purportedly required disclosures under Item 303 can give rise to liability under Section 10(b) and Rule 10b–5(b), so long as the other elements of a federal securities fraud claim have been established. Pet. App. 8a. In relevant part, Item 303 requires companies to describe, in Form 10-Ks and Form 10-Qs, "known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(b)(2)(ii).[2]

In so holding, the Second Circuit applied its ruling in *Stratte-McClure* that "a failure to make a required Item 303 disclosure" is "an omission that can serve as the basis for" a violation of Section 10(b) and Rule 10b–5. 776 F.3d at 100–01. *Stratte-McClure* views an issuer's failure to disclose Item 303 information as an actionable half-truth fraud under Rule 10b–5(b). *Id.* at 101. Indeed, the Second Circuit quoted Rule 10b–5(b), stating that "failing to comply with Item 303 by omitting known trends or uncertainties" is actionable because "Rule 10b–5 requires disclosure of 'material fact[s] necessary in

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[2] Item 303 was amended in 2021. The modifications do not impact the question presented. *See* Pet. Br. at 10–11. Unless otherwise noted, this brief cites the current version.

order to make . . . statements made . . . not misleading.'" *Id.* (quoting Rule 10b–5(b)).

The Second Circuit was mistaken, however, about Rule 10b–5(b). Its rulings in *Stratte-McClure*—and in this case—do *not* comport with that subsection of the Rule (or any other part of the Rule), or the half-truth-fraud principles on which the relevant language in subsection (b) is based.

Rule 10b–5(b) contains two prongs. The first prong prohibits affirmative misstatements. 17 C.F.R. § 240.10b–5(b) ("it shall be unlawful . . . to make any untrue statement of a material fact."). The second prong provides: "[i]t shall be unlawful . . . to omit to state a material fact necessary in order to make the statements made . . . not misleading . . . in connection with the purchase or sale of any security." *Id.* This second prong reflects the common-law principles of a "half-truth" fraud. *United States v. Laurienti*, 611 F.3d 530, 539 (9th Cir. 2010) ("Subsection (b) of Rule 10b–5 prohibits the telling of material lies and prohibits the telling of material *half-truths*") (emphasis added). Under the plain meaning of the second prong of Rule 10b–5(b)—and likewise under the common law—fraud is found only when a plaintiff identifies an affirmative false statement that amounts to an actionable half-truth.

A. The Second Circuit's Holding Departs from Half-Truth-Fraud Principles Reflected in Rule 10b–5(b)

A half-truth, as set forth in Rule 10b–5(b), is an affirmative statement that is true, but omits information that is necessary to prevent the statement from being misleading. *See, e.g.*, *In re*

Vivendi, S.A. Sec. Litig., 838 F.3d 223, 239–40 (2d Cir. 2016) ("half-truths [are] statements that are misleading . . . by virtue of what they omit to disclose"). In other words, a half-truth contains a partial disclosure of facts that is misleading in the absence of certain additional facts. A person who makes an affirmative statement has a "duty to disclose" the missing information. *See Laurienti*, 611 F.3d at 541. The duty arises solely from the telling of a potentially misleading statement, independent of any other duties that the declarant may have. *Id.* Finally, half-truth liability is imposed only when a declarant speaks on a *particular* topic and omits information about the *same* topic necessary to render the initial statement not misleading. *See Setzer v. Omega Healthcare Invs., Inc.*, 968 F.3d 204, 214 n.15 (2d Cir. 2020).

Given the nature of half-truth fraud, the only fraud theory regarding "trends" and "uncertainties" that could conceivably satisfy Rule 10b–5(b) is a theory asserting that *affirmative statements* made in an issuer's periodic filings were misleading due to the failure to disclose certain trends and uncertainties.

Again, under this Rule 10b–5(b) theory, it would not matter whether the trends and uncertainties at issue were otherwise the subject of some statutory or regulatory requirement (like Item 303). Simply put, affirmative statements in an issuer's filings with the SEC either are misleading half-truths in the absence of other information, or they are not. If the statements *are* misleading half-truths, they could be actionable under Rule 10b–5(b), even if some other regulation or statute does *not* require the disclosure of additional information.

Likewise, if statements are *not* misleading half-truths, they are *not* actionable under Rule 10b–5(b), even if some other regulation or statute *does* require disclosure of the missing information. In short, whether a statement is misleading under Rule 10b–5(b) does not turn on the existence of an independent statutory or regulatory disclosure duty over the information at issue.

The decision below does *not* posit that what makes an issuer's periodic disclosures misleading is the failure to meet a freestanding requirement to disclose material information about known trends and uncertainties. Nor *could* the Second Circuit have properly adopted such a theory, because it proves too much. After all, anytime an issuer presents some, but not all, known financial information, shareholders are getting an arguably "incomplete" picture of the company's financial condition. But if an issuer's financial statements were considered misleadingly incomplete whenever they omit material financial information—be it material information on "trends" and "uncertainties" or any other financial information—issuers would be under a duty to disclose *all* material financial information anytime they present *any* material financial information.

This Court has never recognized such a sweeping duty. On the contrary, the Court has made clear no such duty exists. *See Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44 (2011) ("[Section] 10(b) and Rule 10b–5 do not create an affirmative duty to disclose any and all material information"); *see also, e.g.*, *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993) (no duty to disclose material financial information "merely because a reasonable investor

would very much like to know" that information). Indeed, virtually every circuit that has examined the issue has held that incomplete statements are not actionable, rather only misleading statements are actionable. *See, e.g.*, *Emps.' Ret. Sys. of Rhode Island v. Williams Cos., Inc.*, 889 F.3d 1153, 1168 (10th Cir. 2018) ("Rule 10b–5 'prohibit[s] *only* misleading and untrue statements, not statements that are incomplete.'" (citation omitted)); *In re Rigel Pharms., Inc. Sec. Litig.*, 697 F.3d 869, 880 n.8 (9th Cir. 2012) ("[S]ection 10(b) and Rule 10b–5 prohibit only misleading and untrue statements, not statements that are incomplete."); *Ind. Elec. Workers' Pension Tr. Fund v. Shaw Grp.*, 537 F.3d 527, 541 (5th Cir. 2008) (An "incomplete disclosure is actionable only if what they said is misleading"); *Winer Fam. Tr. v. Queen*, 503 F.3d 319, 330 (3d Cir. 2007) ("Liability may exist under Rule 10b–5 for misleading or untrue statements, but not for statements that are simply incomplete.").[3]

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[3] To be sure, if an issuer makes affirmative statements about some specific subject—such as "trends" and "uncertainties"—then the issuer is under a duty to fully disclose related material facts *on the same subject* so that the affirmative statements would not be misleading and give rise to liability under Rule 10b–5(b). Indeed, every circuit court to consider the issue has concluded that the half-truth theory of liability requires the actionable omission to be on the same specific topic as the affirmative statement made. *Meyer v. Jinkosolar Holdings Co.*, 761 F.3d 245, 250 (2d Cir. 2014); *FindWhat Investor Grp. v. FindWhat.com*, 658 F.3d 1282, 1305 (11th Cir. 2011); *In re K-Tel Int'l, Inc. Sec. Litig.*, 300 F.3d 881, 898 (8th Cir. 2002). Even this potential source of liability, however, is subject to strict limitations: "[m]erely mentioning a topic . . . does not require the company to disclose every tangentially related fact that might interest investors." *Anderson v. Abbott Labs.*, 140 F. Supp. 2d

The requirement that a plaintiff asserting a half-truth theory must plead the existence of a particular affirmative statement (as opposed, for example, to an entire document) that is allegedly made misleading because of the omission also is reflected in the Private Securities Litigation Reform Act of 1995 (PSLRA). *See* Pet. Br. at 35–38. The PSLRA mandates that a plaintiff identify exactly which specific statements are made misleading by the omissions at issue, and the reason or reasons each statement is misleading. 15 U.S.C. § 78u-4(b)(1)(B); *see also, e.g.*, *Anderson*, 140 F. Supp. 2d at 903–04 (plaintiffs' failure to identify specific statements made misleading by defendants' omissions "fatal to th[eir] claims"). In sum, the plain language of Rule 10b–5(b) and the PSLRA both make clear that a half-truth-fraud claim requires a specific, identifiable affirmative statement. *See* Pet. Br. at 35–36.

Here and in *Stratte-McClure*, however, the Second Circuit does not even purport to identify any specific affirmative statements on any particular topic made by the issuers giving rise to a private right of action under Section 10(b) and Rule 10b–5. The Second Circuit merely references the absence of a purportedly required Item 303 disclosure in a periodic filing. Relying in this holistic fashion on an issuer's entire periodic filing without identifying specific alleged false and misleading statements on given topics, does not satisfy the requirements of Rule 10b–5(b), or the requirements of the PSLRA. The Second Circuit's failure to identify any such specific affirmative misstatements further shows that

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894, 903 (N.D. Ill. 2001), *aff'd sub nom*, *Gallagher v. Abbott Labs.*, 269 F.3d 806 (7th Cir. 2001).

although the Second Circuit in *Stratte-McClure* points specifically to Rule 10b–5(b), its analysis and holding do not comport with that subsection.

Finally, the case law on which the Second Circuit relies demonstrates there is no basis in Rule 10b–5(b) or the half-truth rule for the court's holding. In support of its holding that the failure to disclose known trends and uncertainties can give rise to fraud liability, the Second Circuit in *Stratte-McClure* points to four circuit court decisions. 776 F.3d at 102 (citing *Glazer v. Formica Corp.*, 964 F.2d 149, 157 (2d Cir. 1992); *Backman v. Polaroid Corp.*, 910 F.2d 10, 20 (1st Cir. 1990) (*en banc*); *Oran v. Stafford*, 226 F.3d 275, 285–86 (3d Cir. 2000); *Gallagher v. Abbott Labs.*, 269 F.3d 806, 808 (7th Cir. 2001)). None of these decisions, however, found liability under Rule 10b–5(b) based on a failure to disclose information required to be disclosed by a statute or regulation.[4] Indeed, the cited portions of those four decisions do not even specifically discuss Rule 10b–5(b) or mention half-truth fraud.

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[4] This line of cases traces back to the First Circuit's opinion in *Roeder v. Alpha Industries, Inc.*, 814 F.2d 22, 26 (1st Cir. 1987). *See Glazer*, 964 F.2d at 157 (citing *Roeder*); *Backman*, 910 F.2d at 20 (same). In *Roeder*, the First Circuit notes the plaintiff's argument that "a corporation has an affirmative duty to disclose all material information even if there is no insider trading, no statute or regulation requiring disclosure, and no inaccurate, incomplete, or misleading prior disclosures." *Roeder*, 814 F.2d at 27. The court then flatly rejects this argument. *Id.* The Second Circuit's reliance on *Roeder*'s progeny is unavailing. The Second Circuit's determination that Item 303 affirmatively creates a duty of disclosure actionable under Section 10(b) is an insupportable extension of the law.

B. The Second Circuit's Holding is Grounded in a "Pure Omission" Fraud Theory Outside the Bounds of Rule 10(b)–5(b)

As shown above, despite the Second Circuit's reference in *Stratte-McClure* to Rule 10b–5(b), the *substance* of the Second Circuit's holding is incompatible with half-truth fraud.

In explaining its holding, the Second Circuit in *Stratte-McClure* began by emphasizing that under its analysis, what serves as the "basis for a securities fraud claim" is a violation of "Item 303's affirmative duty to disclose in Form 10-Qs." 776 F.3d at 101. The Second Circuit went on to explain exactly how, in the court's view, a violation of Item 303 misleads investors: "Due to the obligatory nature of [Item 303], a reasonable investor would interpret the *absence* of an [Item 303] disclosure to *imply the nonexistence* of 'known trends or uncertainties . . . that the registrant reasonably expects will have a material . . . unfavorable impact on . . . revenue or income from continuing operations.'" *Id.* at 102 (emphasis added).

This explanation is revealing. It makes clear that the Second Circuit's fraud theory is based on a *pure omission*, not a half-truth. A pure omission is a complete failure to make a statement, as contrasted with a half-truth, which involves making an affirmative statement that is misleadingly incomplete. *See, e.g.*, *Litwin v. Blackstone Grp. L.P.*, 634 F.3d 706, 719 (2d Cir. 2011); *see also* Restatement (Second) of Torts § 551 (1977) (fraud liability arises from a pure omission where one "fails to disclose to another a fact . . . [in circumstances in which it is] as

though he had represented the nonexistence of the matter that he has failed to disclose").

The decision below removes any doubt about whether *Stratte-McClure* intended to impose Rule 10b–5 liability for pure omissions. The Second Circuit said (wrongly) that Rule 10b–5 "*prohibit[s] material omissions*" and that "[t]he failure to make a material disclosure required by Item 303 can serve as the basis for claims under [Rule 10b–5]." Pet. App. 8a (emphasis added). Further, the Second Circuit separated out Item 303's disclosure duty and Rule 10b–5's half-truth prohibition as *separate* bases for liability. The Second Circuit reasoned that there were "two" actionable circumstances for omissions: (1) when there is "a statute or regulation requiring disclosure" and (2) when "a company speaks on an issue or topic, there is a duty to tell the whole truth." Pet. App. 6a. And in analyzing this case, the Second Circuit discussed Item 303's regulatory duty and Plaintiffs' half-truth theory in separate sections. *Compare* Pet. App. 7a *with* 10a. This confirms that, whatever label *Stratte-McClure* may have used, the Second Circuit has expanded Rule 10b–5 to cover pure omissions.

But Rule 10b–5(b) does not cover pure omissions. It is clear from the plain language of subsection (b) that it only covers affirmative misstatements and half-truths. That Rule 10b–5(b) does not cover pure omissions (including omissions of facts required to be disclosed by statute or regulation) is also confirmed by a comparison of the Rule with Section 11 of the Securities Act of 1933. *See* Pet. Br. at 25–29. Section 11 permits civil suits by purchasers of securities where the registration statement

"contain[s] an untrue statement of a material fact or *omit[s] to state a material fact required to be stated therein* or necessary to make the statements therein not misleading." 15 U.S.C. § 77k (emphasis added).

Thus, the plain language of Section 11 clarifies that liability under that section arises from an issuer's *omission of facts required to be disclosed*. Neither subsection (b) nor any other subsection of Rule 10b–5 contains any such language, which confirms that Rule 10b–5(b) was not intended to cover such omissions. The absence of such language in Rule 10b–5(b) further exposes that the Second Circuit erred in *Stratte-McClure* when it suggested that liability under Rule 10b–5(b) can arise from a pure omission. *See, e.g.*, *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1055–56 (9th Cir. 2014).

II. THE SECOND CIRCUIT'S HOLDING IS AN UNWARRANTED EXPANSION OF THIS COURT'S SECTION 10(b) JURISPRUDENCE

As shown in Part I above, the decision below conflicts with the common law half-truth doctrine and Rule 10b–5(b). The remaining question is whether the Second Circuit's theory satisfies the requirements for fraud under Section 10(b) on some basis *other than* Rule 10b–5(b) (even though the Second Circuit seemed to assume that only that provision applied). The answer is no. Breaching a disclosure obligation under Item 303 does *not* satisfy the requirements of a viable fraud-by-omission claim under traditional common law fraud principles or follow this Court's

jurisprudence on Section 10(b) and subsections (a) and (c) of Rule 10b–5.[8]

A. The Second Circuit's Holding Conflicts with the Common Law of Fraud by Omission

The decision below contradicts the common law of fraud by omission. Section 551 of the Restatement (Second) of Torts provides that a party to a business transaction who fails to disclose certain information that "induces the other to act or refrain from acting" in the business transaction "is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, *if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question*." Restatement (Second) of Torts § 551 (emphasis added).

Section 551 specifies only five narrow scenarios in which "one party to a business transaction is under a duty to exercise reasonable care to disclose" information "to the other [party] before the transaction is consummated." *Id.* § 551(2). Under the first scenario, a party to a business transaction may be liable for fraudulent omission if the person fails to disclose "matters known to him that the other is entitled to know because of a *fiduciary or other similar relation* of trust and confidence between

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[8] Rule 10b–5(a) and (c) provide that is shall be unlawful "(a) [t]o employ any device, scheme, or artifice to defraud, [or] . . . (c) [t]o engage in any act, practice, or course of business which operates as a fraud or deceit upon any person, in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b–5(a),(c). As Petitioners note, subsections (a) and (c) apply to "something more or different than speech alone." Pet. Br. at 23.

them." *Id.* § 551(2)(a) (emphasis added). Section 551 then identifies four other (even more uncommon) scenarios, each of which concerns the "parties to a transaction."

An issuer's nondisclosure of trends and uncertainties required to be disclosed in Item 303 does not rise to the level of an actionable nondisclosure under Section 551 for two reasons.

First, fraud liability for a pure omission under the common law principles reflected in Section 551 attaches only where the nondisclosure by a defendant occurs in connection with a transaction to which the defendant is a party. *Id.* Here (as in *Stratte-McClure*), the theory of liability is not based on a transaction to which the issuer was a party. On this basis alone, the Second Circuit's theory of fraud by pure omission does not track common law fraud by omission.

Second, Section 551 specifies that there must be either a "fiduciary or other similar relation of trust and confidence between" the person who fails to disclose the information at issue, and the other party to the transaction, or some other special circumstance enumerated in Section 551. No such special circumstances are present here (or in *Stratte-McClure*). Indeed, the common law is clear that there is no actionable fiduciary or fiduciary-like relationship between an issuer and its shareholders that would support liability under Section 551. *See, e.g.*, *In re Solera Ins. Coverage Appeals*, 240 A.3d 1121, 1135 (Del. 2020). Hence, Section 551 does not support the Second Circuit's theory of fraud.

B. The Second Circuit's Holding Conflicts with the Court's Section 10(b) and Rule 10b–5 Jurisprudence

The decision below also does not square with the Court's Section 10(b) and Rule 10b–5 jurisprudence on fraudulent omissions, which the Court has made clear reflect common-law principles of fraud—including those contained in Section 551.[5]

Chiarella and *O'Hagan*—which relied on *Chiarella* in adopting the "misappropriation theory" of insider trading[6]—are the Court's notable Section 10(b) cases involving omissions. In *Chiarella*, the Court expressly cited Section 551 of the Restatement (Second) of Torts in examining a failure to disclose that did not result in an affirmative misrepresentation. Consistent with Section 551, *Chiarella* and *O'Hagan* determined that a person's failure to disclose information could give rise to liability for insider trading under Section 10(b) and Rule 10b–5(a) or (c) if two threshold elements were established (in addition to the other requirements of those subsections of Rule 10b–5):

The first of those elements is the presence of a special relationship—in particular, a relationship of trust and confidence. *Chiarella*, 445 U.S. at 228;

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[5] *See Basic, Inc. v. Levinson*, 485 U.S. 224, 231 (1988) (noting that the Court in six prior decisions had "addressed various positive and *common-law* requirements for a violation of § 10(b) or of Rule 10b–5" (emphasis added)).

[6] *United States v. O'Hagan*, 521 U.S. 642 (1997).

O'Hagan, 521 U.S. at 652; Restatement (Second) of Torts § 551.[7]

The second required element is the presence of a *transaction* to which the defendant was a party and in connection with which the defendant made personal use, for his own personal benefit, of material nonpublic information. *Chiarella*, 445 U.S. at 229; *O'Hagan*, 521 U.S. at 652. Under both *Chiarella* and *O'Hagan*, if there is no transaction at issue to which the defendant is a party, the defendant has no duty to disclose and thus cannot be liable for a fraudulent omission under Section 10(b). *See Chiarella*, 445 U.S. at 230 ("[L]iability is premised upon a duty to disclose arising from a relationship of trust and confidence between *parties to a transaction*." (emphasis added));[8]

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[7] The Court in *Chiarella* held that Section 10(b) liability can be "premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction." 445 U.S. at 230. Under the common law, which *Chiarella* reviewed, there were causes of action for misrepresentations and half-truths, but as a general rule, nondisclosures were not actionable. *See* Frank F. Coulom Jr., *Rule 10b–5 and the Duty to Disclose Market Information: It Takes a Thief*, 55 St. John's L. Rev. 93, 96–97 (1980). This rule, based on the principle of *caveat emptor*, served to reward diligence and business savvy. *Id.* Nevertheless, there was an exception to this general rule: where there was a fiduciary relationship between the parties. *Id.* Such a duty arose, for example, where there was a principal–agent, executor–beneficiary, or trust relationship. *Id.* This duty did *not* apply to arm's-length commercial transactions. *Id.* The Court in *Chiarella* cited Section 551, which, consistent with this common-law precedent, provides that "the duty to disclose arises when one party has information 'that the other party is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.'"

[8] In *Chiarella*, in the same passage in which the Court cited Section 551, the Court cited approvingly a law review article

O'Hagan, 521 U.S. at 656 ("[T]he fiduciary's fraud is consummated, *not* when the fiduciary gains the confidential information, but when, without disclosure to his principal, he *uses* the information to purchase or sell securities. *The securities transaction and the breach of duty thus coincide*." (emphasis added)).

Thus, *Chiarella* and *O'Hagan* stand for the proposition that a transaction (in those two cases, an *insider trading* transaction) is a necessary condition for Section 10(b) liability to arise in connection with a nondisclosure.

The Second Circuit's holdings below and in *Stratte-McClure* squarely conflict with the Court's Section 10(b) jurisprudence. The Second Circuit imposes fraud liability for an omission by an issuer in connection with the issuance of financial results in filings with the SEC even if the issuer was *not* itself participating in any business transaction with its investors when it published those results. Nor did the issuer have an actionable fiduciary relationship with its shareholders in connection with the issuance of its financial results. For these reasons, the Court should reject the Second Circuit's fraud theory. Adopting that theory would amount to a substantial and unwarranted departure from the Court's Section 10(b) jurisprudence and the common-law principles reflected in it.

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discussing instances of nondisclosure liability under the common law (as reflected in Section 551). 445 U.S. at 228 n.9 (citing Fleming James & Oscar S. Gray, *Misrepresentation—Part II*, 37 Md. L. Rev. 488, 523–27 (1978)). In every instance discussed by the law review article, the defendant was a party to a transaction. James & Gray, 37 Md. L. Rev. at 523–27.

It is a bedrock principle of Section 10(b) jurisprudence—which this Court has repeatedly reaffirmed—that although what Section 10(b) was designed to catch was fraud, it is not to be construed as encompassing the entire common law of fraud.[9] Indeed, there are some instances of common-law fraud relating to the purchase or sale of securities that do not violate Section 10(b).[10] *See, e.g.*, *SEC v. Zandford*, 535 U.S. 813, 820 (2002) ("[Section 10(b)] must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation"); *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982) ("Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud").

Because this Court has made clear that Section 10(b) is not broad enough to capture every kind of fraud within the common law, the Court should not embrace a Section 10(b) theory like the Second

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[9] *Chiarella*, 445 U.S. at 234–35 ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak."); *see also Dirks v. SEC*, 463 U.S. 646, 657 (1983) (a duty to speak "attaches only when a party has legal obligations other than a mere duty to comply with general antifraud proscriptions in the federal securities laws").

[10] Just as Section 10(b) is limited in this regard, so too is Rule 10b–5. *See, e.g.*, *O'Hagan*, 521 U.S. at 651 ("liability under Rule 10b–5, our precedent indicates, does not extend beyond conduct encompassed by § 10(b)'s prohibition" (citing Ernst & Ernst*,* 425 U.S. at 214 (scope of Rule 10b–5 cannot exceed power Congress granted Commission under § 10(b))).

Circuit's that falls even *outside* the bounds of the common law.[11]

III. ADOPTING THE SECOND CIRCUIT'S FRAUD THEORY WOULD HARM INVESTORS AND ISSUERS AND UNDERMINE THE SEC'S APPROACH TO ITEM 303

As explained above, this Court should reject the Second Circuit's holding and hold that a failure to make a required 303 disclosure by itself does *not* give rise to a private right of action under Section 10(b) and Rule 10b–5. *See NVIDIA*, 768 F.3d at 1055–56; *Oran*, 226 F.3d at 288; *Carvelli v. Ocwen Fin. Corp.*, 934 F.3d 1307, 1331 (11th Cir. 2019). Moreover, this position is supported by critical public policy concerns. The Court routinely considers public policy in connection with Section 10(b) and Rule 10b–5. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975) (finding it "proper that [the Court] consider . . . what may be described as policy considerations when we come to flesh out the portion

[11] Moreover, this Court has rightfully and repeatedly recognized that "[c]oncerns with the judicial creation of a private cause of action caution against [10(b)'s] expansion." *See Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 165 (2008); *Janus Cap. Grp., Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011). As such, the Court "must give 'narrow dimensions . . . to a right of action Congress did not authorize when it first enacted the statute and did not expand when it revisited the law.'" *Janus Cap. Grp., Inc.*, 564 U.S. at 142 (quoting *Stoneridge Inv. Partners, LLC*, 552 U.S. at 167). A determination that an omission pursuant to Item 303 is actionable under Section 10(b)—when such an omission is not even actionable under basic principles of the common law of fraud—hardly gives the appropriately "narrow dimensions" to Section 10(b) that the Court has mandated. *See supra* Part II.A.

of the law with respect to which neither the congressional enactment nor the administrative regulations offer conclusive guidance"). Adopting the Second Circuit's rule would undermine the purpose of Item 303 and trigger a deluge of disclosures and a spike in shareholder litigation.

A. Affirming the Second Circuit Would Undermine the Purpose and Benefits of Item 303

The Management Discussion and Analysis (MD&A) portion of a company's securities filings is intended to be helpful to readers and easy to follow and understand. Item 303 disclosures are found in the MD&A. Their purpose is threefold: (1) "to provide a narrative explanation of a company's financial statements that enables investors to see the company through the eyes of management"; (2) "to enhance the overall financial disclosure and provide the context within which financial information should be analyzed"; and (3) "to provide information about the quality of, and potential variability of, a company's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance." Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, 68 Fed. Reg. 75056 (Dec. 29, 2003); *see also* 17 C.F.R. § 229.303(a) ("A discussion and analysis that meets the requirements of [Item 303] is expected to better allow investors to view the [company] from management's perspective.").

Complying with obligations under securities disclosure laws is always a challenge. *See SEC v. Bausch & Lomb Inc.*, 565 F.2d 8, 9 (2d Cir. 1977)

(comparing it to "a fencing match conducted on a tightrope"). Indeed, the SEC has said complying with Item 303 "may be particularly challenging." Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6290, 6295 (Feb. 8, 2010); *see In re Canandaigua Sec. Litig.*, 944 F. Supp. 1202, 1210 (S.D.N.Y. 1996). That is because "Item 303 is broad and ambiguous" and "intentionally general." *See Diehl v. Omega Protein Corp.*, 339 F. Supp. 3d 153, 167 (S.D.N.Y. 2018).

According to the SEC, this "flexible approach" elicits "more meaningful disclosure and avoids boilerplate discussions." *Id.* (citation omitted); Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, 54 Fed. Reg. 22427 (May 24, 1989); *see also* Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Data, and Supplementary Financial Information, 86 Fed. Reg. 2080, 2094 (Jan. 11, 2021) (emphasizing that the SEC specifically crafted Item 303's requirements to avoid "voluminous disclosures or unnecessarily speculative information"). In fact, the SEC urges companies to avoid "unnecessary duplicative disclosure that can tend to overwhelm readers" and to "focus on material information and eliminate immaterial information that does not promote understanding of companies' financial condition." Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, 68 Fed. Reg. 75056, 7057 (Dec. 29, 2003); *see also id.* ("[C]ompanies should avoid the unnecessary information overload for investors that can result

from disclosure of information that is not required, is immaterial, and does not promote understanding.”).

The Second Circuit’s approach would undermine the intent and purpose of the MD&A and Item 303. As this Court has cautioned, an overbroad view of Rule 10b–5’s private right of action encourages over-disclosure, “lead[ing] management simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.” *Basic*, 485 U.S. at 231–32. By imposing private liability for a pure omission—something Section 10(b) and Rule 10b–5 do not otherwise do—the Second Circuit has all but guaranteed that companies will err on the side of disclosing all “known trends,” regardless of relevance. There is no consequence for over-disclosure. But the consequence for under-disclosure could be a securities class action that, at best, will absorb years of a company’s time and resources and, at worst, could impose significant financial liability. If companies are faced with the specter of class action lawsuits for failure to make adequate Item 303 disclosures, companies will opt to over-disclose, which will wipe out the benefit of Item 303.[12]

[12] If adopted by the Court, the Second Circuit’s rule would inevitably expand beyond Item 303 to other SEC rules and disclosures requirements, significantly broadening the scope of Section 10(b) and Rule 10b–5 liability without any change to the underlying statute or rule. For example, a company could potentially be held liable for failing to disclose all properties where the company or its subsidiaries have operations pursuant to Item 102 or failing to disclose all market risks (which are inherently uncertain) under Item 304. And each new disclosure requirement promulgated by the SEC would risk further expansion of a private right of action. To cite just one current

Nor will the Second Circuit's rule encourage more thoughtful disclosures. Item 303 disclosures are already mandatory and enforced by the SEC. *See* Pet. Br. at 29–31. Under the circumstances, it makes sense that the SEC is Item 303's sole enforcer. The SEC can calibrate its enforcement efforts to promote Item 303's goals—in part by using less draconian measures than litigation to ensure necessary disclosures. *See id.* at 42–46. Deputizing the plaintiffs' bar to enforce Item 303 will have the opposite effect, turning Item 303's flexible approach in on itself.

B. Adopting the Second Circuit's Holding Would Trigger an Unwarranted Spike in Shareholder Litigation

There can be little doubt that adopting the Second Circuit's holding will cause a flood of litigation. As this Court has recognized, these types of suits "can be employed abusively to impose substantial costs on companies and individuals whose conduct conforms to the law." *Tellabs, Inc. v. Makor Issues & Rts., Ltd.*, 551 U.S. 308, 313 (2007). This Court has further acknowledged the risk that "broadly expand[ing] the class of plaintiffs who may sue under Rule 10b–5" increases the risk that private

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example, the SEC has proposed a complex rule requiring companies to include certain climate-related disclosures in their registration statements and annual reports. *See* The Enhancement and Standardization of Climate Related Disclosures for Investors, 87 Fed. Reg. 21334 (Apr. 11, 2022). The practical import is that the Second Circuit's rule would make Rule 10b–5 liability a moving target, further encouraging over-disclosure.

securities litigation will be used to coerce an "*in terrorem*" settlement. *See Blue Chip Stamps*, 421 U.S. at 741.[13] Allowing suits to proceed on a pure-omission theory under Item 303 will only exacerbate this problem.

Given Item 303's deliberately vague and forward-looking standard, plaintiffs will have little difficulty claiming, with the benefit of hindsight, that an issuer missed a "trend" that later harmed its business. [14] The plaintiffs' bar will be poised to attack

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[13] Stanford Law School's Securities Class Action Clearinghouse aggregates all securities class actions and estimates that nearly half of all securities class actions settle and that such settlements total over $113 billion. SECURITIES CLASS ACTION CLEARINGHOUSE: FILINGS DATABASE, https://perma.cc/4KQA-TJ4F (last visited Nov. 13, 2023).

[14] It is no answer to say that the Second Circuit's approach still requires a plaintiff to show materiality and scienter. *See In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989) ("Materiality and scienter are both fact-specific issues which should ordinarily be left to the trier of fact."). Courts rarely dismiss claims based on a failure to adequately plead materiality because materiality is "a mixed question of law and fact." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450 (1976); *see also Ganino v. Citizens Utils. Co.*, 228 F.3d 154, 162 (2d Cir. 2000) ("a complaint may not properly be dismissed . . . on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance"). The plaintiffs' bar simply will argue that any stock-price drop that occurs once the information is disclosed is sufficient evidence of materiality at the motion-to-dismiss stage. *See, e.g.*, *Oran*, 226 F.3d at 282 ("when a stock is traded in an efficient market, the materiality of disclosed information may be measured post hoc by looking to the movement, in the period immediately following disclosure, of the price of the firm's stock").

companies' periodic filings for alleged Item 303 deficiencies—without having to identify any misleading statement. This would substantially obviate the PSLRA's pleading requirement that the plaintiff identify the statement that is misleading and the reasons why the statement was misleading when made.

Moreover, adopting the Second Circuit's rule would increase the amount of otherwise meritless fraud-by-omission cases that survive motions to dismiss and class certification. To date, securities fraud-by-omission cases have been less frequent than misstatement cases. But adopting the Second Circuit's holding coupled with the presumption of reliance established in *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153–54 (1972), will likely flip that relative frequency.

Affiliated Ute established the presumption that "if there is an omission of a material fact by one with a duty to disclose, the investor to whom the duty was owed need not provide specific proof of reliance." *Stoneridge Inv. Partners*, 552 U.S. at 159 (citing *Affiliated Ute*, 406 U.S. at 153–54). The presumption arises "if there is an omission of a material fact by one with a duty to disclose." *Stoneridge Inv. Partners,* 552 U.S. at 159. The Court reasoned that "[r]equiring a plaintiff to show a speculative state of facts, i.e., how he would have acted if omitted material information had been disclosed . . . would place an unnecessarily unrealistic evidentiary burden on the Rule 10b–5 plaintiff who has traded on an impersonal market." *Basic*, 485 U.S. at 245.

If the Court adopts the Second Circuit's theory, there will be an increase in the number of class

actions alleging securities fraud by omission under Item 303 (and, as mentioned above, likely other SEC disclosure provisions). These plaintiffs will rely on *Affiliated Ute* at the class-certification stage to establish a rebuttable presumption of reliance (a critical element of a Section 10(b) claim). The impact will be not only *more* securities class actions under Section 10(b), but more cases advancing beyond class certification. This will lead to protracted litigation, burden the courts, and drive-up litigation and settlement costs for companies—all with no net benefit to shareholders and investors, who will instead be inundated with ultimately useless, immaterial disclosures.

CONCLUSION

The Court should reverse.

Respectfully submitted,

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