No. 22-1165

In The
Supreme Court of the United States

MACQUARIE INFRASTRUCTURE CORP., JAMES HOOKE, JAY DAVIS, LIAM STEWART, RICHARD D. COURTNEY, ROBERT CHOI, MARTIN STANLEY, NORMAN H. BROWN, JR., GEORGE W. CARMANY, III, HENRY E. LENTZ, OUMA SANANIKONE, WILLIAM H. WEBB, and MACQUARIE INFRASTRUCTURE MANAGEMENT (USA) INC.,

Petitioners,

v.

MOAB PARTNERS, L.P., et al., on behalf of itself and all others similarly situated,

Respondents.

On Writ Of Certiorari To The U.S. Court Of Appeals For The Second Circuit

BRIEF OF LAW AND BUSINESS PROFESSORS AS *AMICI CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether an omission of material information required to be disclosed under Item 303 of S.E.C. Regulation S-K in periodic reports is actionable under Rule 10b-5, where plaintiff adequately pleads all other elements of a cause of action under Rule 10b-5.*

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* Our references are from the existing version of Item 303 which was modestly amended in 2020. *See Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, Exchange Act Release No. 90,459, 86 Fed. Reg. 2080 (Nov. 19, 2020).

TABLE OF CONTENTS

	Page
INTEREST OF *AMICI CURIAE*	1
SUMMARY OF ARGUMENT	2
ARGUMENT	7
A. The Requirement that Companies Provide Disclosure under the Periodic Reporting Process Creates a Duty to Disclose Under the Antifraud Provisions	10
B. The Existence of a Duty to Disclose Information Required by Item 303 is Consistent with, and Compelled by, this Court's Reasoning in *Omnicare*	16
C. The Failure to Reaffirm that Disclosure Requirements Contained in Item 303 can give rise to an Action under Rule 10b-5 will Weaken Enforcement and Result in Disclosure that does not Meet the Expectations of Reasonable Investors	22
D. The Reaffirmation that Disclosure Requirements Contained in Item 303 can give rise to an Action under Rule 10b-5 will not Result in Information Overload; to the Extent Additional Disclosure Occurs, it will Benefit Investors	27
CONCLUSION	30

TABLE OF CONTENTS—Continued

Page

APPENDIX

Amici Curiae .... App. 1

TABLE OF AUTHORITIES

Page

CASES

Basic v. Levinson, 485 U.S. 224 (1988) 10, 30

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 3, 13, 15

In re GTT Communications, Inc., Exchange Act Release No. 98,491 (Admin. Proc. Sept. 25, 2023) 12

Herman & MacLean v. Huddleston, 459 U.S. 375 (1983) 15

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In re Massey Energy Co. Deriv. & Class Action Litig., 2011 WL 2176479 (Del. Ch. May 31, 2011) 12

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In re Nvidia Corp., Sec. Litig., 768 F.3d 1046 (9th Cir. 2014) 16

In re Orion Financial, Ltd., Exchange Act Release No. 98,968 (Admin. Proc. Nov. 16, 2023) 7

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TABLE OF AUTHORITIES—Continued

Page

Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, et al., 575 U.S 175 (2015) 4, 16, 17, 21

S.E.C. v. Jensen, 835 F.3d 1100 (9th Cir. 2016)..........26

S.E.C. v. Beisinger Indus. Corp., 552 F.2d 15 (1st Cir. 1977) 7

S.E.C. v. Rio Tinto PLC, 41 F.4th 47 (2d Cir. 2022)....2, 10

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15 U.S.C. §77k 13

15 U.S.C. §77k(a)..3, 13

TABLE OF AUTHORITIES—Continued

Page

15 U.S.C. §77l 8
15 U.S.C. §77l(b) 11
15 U.S.C. §77q 8
15 U.S.C. §78j 8
15 U.S.C. §78j(b) 2
15 U.S.C. §78m(a) 8, 24
15 U.S.C. §78u–5(b)(1) 26
15 U.S.C. §78u(d)(2) 13, 26
17 C.F.R. §229.303 2
17 C.F.R. §229.303(a) 9, 19
17 C.F.R. §229.303(a)(1) 9
17 C.F.R. §229.303(a)(4)(i)(D) 9
17 C.F.R. §229.303(b)(1)(ii)(A) 9
17 C.F.R. §229.303(b)(2)(i) 9
17 C.F.R. §229.303(b)(2)(ii) 9
17 C.F.R. §229.303(b)(3) 10
17 C.F.R. §229.303(c)(1) 10
17 C.F.R. §229.303(c)(2) 10
17 C.F.R. §229.307 21
17 C.F.R. §229.601(b)(31)(i) 21
17 C.F.R. §230.506(d)(1)(v) 26
17 C.F.R. §240.10b-5 2
17 C.F.R. §240.10b-5(a) 10

TABLE OF AUTHORITIES—Continued

Page

17 C.F.R. §240.10b-5(b) 10

17 C.F.R. §240.10b-5(c) 10

17 C.F.R. §240.13a-14 21

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TABLE OF AUTHORITIES—Continued

Page

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Page

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Page

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Page

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TABLE OF AUTHORITIES—Continued

Page

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INTEREST OF *AMICI CURIAE*[1]

Amici are scholars at American law schools whose research and teaching focus on federal securities regulation and the governance of public corporations. Three of the authors appearing as counsel on this brief have together submitted to this Court briefs on prior occasions as *amici* in cases arising under the federal securities laws on behalf of law and business faculty.[2] All of us have written and/or taught extensively about the SEC's system of disclosure and our experience includes service in positions that allowed for the participation in the evolution of the system of disclosure developed by the Securities and Exchange Commission.

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[1] This brief was not authored, in whole or in part, by counsel for either party, and no person other than *amici* and their academic institutions, contributed monetarily to the preparation or submission of this brief. None of the schools that employ *amici* are a signatory to this brief, and the views expressed here are not affiliated with those institutions.

[2] A number of the authors on this brief have appeared as counsel in all of the following briefs filed as amicus on behalf of law and business faculty. *See* Brief for Faculty at Law and Business Schools as Amici Curiae Supporting Respondents, *Merck & Co. v. Reynolds*, 559 U.S. 633 (2009) (No. 08-905); Brief for Professors at Law and Business Schools as Amicus Curiae Supporting Respondents, *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27 (2010) (No. 09-1156); Brief for Professors at Law and Business Schools as Amici Curiae Supporting Respondents, *Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, et al.*, 575 U.S. 175 (2015) (No. 13-435); Brief of Professors at Law and Business Schools as Amici Curiae Supporting Respondents, *Leidos, Inc. v. Indiana Public Retirement System, et al.* (2017) (No. 16-581) [hereinafter "Leidos Brief for Law and Business Professors"].

Amici have a common interest in ensuring a proper interpretation of the statutory framework put in place by Congress. While all participating *amici* may not agree with every statement in the brief, all *amici* agree that omissions of disclosure required by Item 303 of Regulation S-K can be the basis for an action under Rule 10b-5. As far as the authors of this brief are aware, *amici* have no financial stake in the outcome of this litigation.

SUMMARY OF ARGUMENT

Omissions of disclosure required by the Securities and Exchange Commission (S.E.C. or Commission) in Item 303 of Regulation S-K, 17 C.F.R. §229.303 can be a basis for an action under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), 15 U.S.C. §78j(b), and Rule 10b-5. 17 C.F.R. §240.10b-5.

Scheme liability under subsections (a) and (c) of Rule 10b-5 encompasses "conduct." *See Lorenzo v. SEC*, 139 S. Ct. 1094, 1100 (2019). Under those provisions, "omissions can form *part* of a scheme liability claim." *S.E.C. v. Rio Tinto PLC*, 41 F.4th 47, 49 (2d Cir. 2022) (emphasis in original). Omissions of material fact can also be actionable under Rule 10b-5(b). Under this provision, silence absent a duty to disclose, is not misleading. The obligation to comply with the disclosure requirements contained in Item 303 can create such a duty, one element of a fraud claim.

Disclosures mandated by the S.E.C. in periodic reports are not optional. Omissions can lead to the imposition of substantial fines, directors can be barred from serving on corporate boards and even criminal prosecutions can result. That these obligations can create a "duty" to disclose under Rule 10b-5(b) is consistent with congressional intent, state court opinions, the common law, and with the longstanding understanding of the federal securities laws (including those of legal scholars and the SEC). This case does not, therefore, seek to "impermissibly expand" the private right of action for securities fraud, *see* Brief for Petitioners, at 38, but instead to reaffirm the availability of an action that has long existed.

Petitioners mostly seek to avoid this result by pointing to language in Section 11 of the 1933 Act. The provision makes actionable the omission of a material fact "required to be stated" in an effective registration statement. 15 U.S.C. §77k(a). Because Rule 10b-5 does not include the same language, Petitioners contend that an omission of S.E.C.-required disclosure cannot be the basis for an action under the Rule. Petitioners' argument is misplaced; they fail to take into account the fundamental differences between the provisions.

As this Court has recognized, liability provisions in the federal securities laws must be examined on a "particularized basis." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200 (1976).

Section 11 varies significantly from other liability provisions, including Section 10(b) and Rule 10b-5,

both in purpose and scope, and cannot be used to effectively limit the broad reach or the longstanding understanding of the antifraud provisions. Section 11 provides for civil liability in the narrow context of misstatements and omissions in effective registration statements. Section 11, then, is not premised on fraud—manipulation or deception—unlike Section 10(b) and Rule 10b-5. Instead, it is narrowly tailored to support an "accurate judgment" on the "value of a security" in a registered offering.

This Court's reasoning in *Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, et al.*, 575 U.S. 175 (2015), further compels a finding that actions for such omissions can be maintained under Rule 10b-5(b). *Omnicare* addressed the treatment of omissions in the context of opinions and beliefs by focusing on the expectations of reasonable investors. To the extent that material facts supporting an opinion were not what such investors expected, the statement would "mislead its audience." *Id*. at 188. Reasonable investors, however, did not "expect that *every* fact" omitted from an opinion would mislead. *Id.* at 190 (emphasis in original). Instead, expectations depended upon "context."

The context of disclosure under Item 303 can create an expectation that trends and other required disclosures will appear in periodic reports and that their omission from those reports can mislead investors. Management's Discussion and Analysis ("MD&A") disclosures are described as the "keystone" to the system of disclosure by public companies, for they are "[o]ne of

the most important elements necessary to an understanding of a company's performance. . . ." Exchange Act Release No. 48,960, *infra*, at *10. Trends and other matters were specifically added to address the fundamental concern that a system of mandatory disclosure limited to historical facts did not meet the needs of investors. MD&A is clear; it requires disclosure of information "known" to management that had the potential for future impact, operating as an early warning system designed to foreshadow adverse developments and unwanted surprises.

In this case, the formal nature of the documents (periodic reports), the centrality of Item 303 to the mandatory disclosure process, and the over-arching requirement of robust disclosure controls that are regularly evaluated, taken together, are sufficient to allege that reasonable investors expected the disclosure of material trends and uncertainties concerning the adverse impact of the regulation put in place by the International Maritime Organization governing the sulfur content of fuel oil ("IMO 2020") and that the omission of that disclosure could be misleading. The result is further compelled by the "widely reported" nature of IMO 2020. *See* Brief for Petitioners, at 11.

Compliance with Item 303, as with the overall content of mandatory disclosure, depends upon an adequate level of enforcement. At the same time, managers face many forces that drive toward non-compliance. Even though the Commission has deployed significant administrative resources, concerns of under-compliance with Item 303 remain. Failure to reaffirm that omissions of required disclosure under Item 303 are

actionable under Rule 10b-5 will reduce enforcement by both private parties and the Commission, further incentivizing nondisclosure.

There is no reason to believe that reaffirming claims under Rule 10b-5 based on omissions of trends and uncertainties will result in "information overload" or otherwise inundate investors with excessive disclosure. This assertion rests on a mistaken view of the equity markets and the methods used by investors to access and absorb information provided by public companies. With these markets increasingly dominated by large institutional investors, analysis of disclosure by public companies is commonly driven by technology, with periodic reports accessed electronically and, increasingly, data filed in a machine-readable format. In this environment, there is no realistic likelihood that additional disclosure of trends will overwhelm with excessive detail the sizable group of informed investors who are critical to price formation.

Regardless, an increase in responsive disclosure of the sort mandated by Item 303 will benefit investors. MD&A has been viewed as particularly significant to investors. Item 303 was promulgated to enhance the utility of information to investors by moving disclosures beyond historical performance. Trend information assists investors in engaging in appropriate risk assessment. Additional disclosure of this type of information provides greater insight into the future direction of a company's finances or operations and alerts investors to conditions and trends that management believes have a reasonable likelihood of a

material impact on operations or finances that would not be discerned merely from disclosure of historical performance.

We believe that the failure to reaffirm that the disclosure requirements contained in Item 303 can give rise to an action under Rule 10b-5, a provision adopted by S.E.C. rulemaking under explicit congressional authorization, will weaken investor confidence in the system of periodic reporting.

For these reasons, *amici* respectfully urge this Honorable Court to find that under the allegations contained in this case, Item 303 imposed a duty to disclose actionable under Section 10(b) and Rule 10b-5(b) and affirm the ruling of the United States Court of Appeals for the Second Circuit.

ARGUMENT

The federal securities laws, including their enforcement provisions, embrace disclosure over direct regulation of the substantive merit of securities or transactions in securities.[3] Built around the concept of

[3] *See In re Orion Financial, Ltd.*, Exchange Act Release No. 98,968, *3 (Admin. Proc. Nov. 16, 2023) (describing the reporting requirements for periodic reports as " 'the primary tool[s] which Congress has fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in the sale of stock and securities.' ") (*quoting S.E.C. v. Beisinger Indus. Corp.*, 552 F.2d 15, 18 (1st Cir. 1977)).

"truth in securities,"[4] reliance on disclosure achieves its purposes of protecting investors and facilitating the aggregation of capital only when the disclosures are trustworthy.[5] As a result, Congress included in these laws strong prohibitions on fraud, including material misstatements and omissions.[6] Achieving this requires vigorous enforcement by both the S.E.C. and private parties.[7]

Section 13(a) of the Exchange Act addressed the informational needs of investors in the secondary markets by authorizing the S.E.C. to put in place a system of continuous disclosure. 15 U.S.C. §78m(a). The foundational belief is that investors should be given "an intelligent basis for forming [their] judgment as to the value of the securities" purchased or sold in the markets. "[T]rue and accurate corporate reporting" had

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[4] *Civil Liability for Misstatements in Documents Filed under Securities Act and Securities Exchange Act*, 44 YALE L. J. 456 (1935).

[5] *See Securities Exchange Bill of 1934*, H.R. Rep. No. 1383, 73rd Cong., 2d Sess., at 11 (1934) (chief provisions of legislation included the "provision of adequate and honest reports to securities holders by registered corporations").

[6] *See* Section 10(b), 15 U.S.C. §78j. *See also* Sections 12 and 17 of the 1933 Act, 15 U.S.C. §§77l & 77q.

[7] *See* Joel Seligman, *Rethinking Private Securities Litigation*, 73 U. CIN. L. REV. 95, 116 n. 99 (2004) ("the history of the S.E.C. and federal securities law, perhaps above all else, has taught that no mandatory disclosure system, no regulatory requirement or prohibition, no S.E.C. review ultimately will effectively work unless the relevant statute or rule is consistently enforced. Periodically the S.E.C. has received an inadequate budget and been understaffed. Private enforcement, warts and all, endures as a pivotal means to ensure law compliance.").

"vital importance . . . " H.R. Rep. No. 1383, 73rd Cong., 2d Sess. 11 (1934).

Under Item 303 of Regulation S-K, Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), companies must "provide material information relevant to an assessment of the financial condition and results of operations . . . including an evaluation of the amounts and certainty of cash flows from operations and from outside sources." 17 C.F.R. §229.303(a). MD&A specifically requires disclosure of trends and uncertainties relating to a company's finances or business operations. *See, e.g.*, 17 C.F.R. §229.303(a)(1), (a)(3)(ii) & (a)(4)(i)(D). The directive is further qualified to clarify that trends must be disclosed if they are "presently known" and are "reasonably likely to have a material effect" on the company's operations or finances.[8] 17 C.F.R. §229.303(b)(2)(ii).

Item 303, however, is not limited to disclosure of trends or uncertainties. MD&A disclosures also must include such matters as material cash requirements, including commitments for capital expenditures, 17 C.F.R. §229.303(b)(1)(ii)(A), and any "unusual or infrequent events or transactions or any significant economic changes" that materially affected "income from continuing operations." 17 C.F.R. §229.303(b)(2)(i). MD&A also requires companies

[8] *Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures*, Exchange Act Release No. 26,831, 54 Fed. Reg. 22427, *4 (May 18, 1989).

to disclose "material changes" in financial condition, 17 C.F.R. §229.303(c)(1), and "results of operations. . . ." 17 C.F.R. §229.303(c)(2), and "critical accounting estimates," 17 C.F.R. §229.303(b)(3).

A. The Requirement that Companies Provide Disclosure under the Periodic Reporting Process Creates a Duty to Disclose Under the Antifraud Provisions

The omission of disclosure required by Item 303 can be actionable under Rule 10b-5 subsection (a), as a "device, scheme, or artifice to defraud," or subsection (c), as an "act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." 17 C.F.R. §§240.10b-5(a) & (c). Violations under these provisions encompass "conduct." *See Lorenzo v. SEC*, 139 S. Ct. 1094, 1100 (2019). Accordingly, "omissions can form part of a scheme liability claim. . . ." *S.E.C. v. Rio Tinto PLC*, 41 F.4th 47, 49 (2d Cir. 2022).

Omissions of material fact required to be disclosed by Item 303 can also be the basis for an action under Rule 10b-5(b). The provision makes it unlawful for a person "[t]o make any untrue statement of a material fact or to omit to state a fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. §240.10b-5(b). Silence, absent a duty to disclose, is not misleading. *Basic v. Levinson*, 485 U.S. 224 239 n. 17 (1988); *see also Stoneridge Inv. Partners, LLC*

v. Scientific-Atlantic, 552 U.S. 148, 159 (2008) (deceptive acts under Section 10(b) include "an omission of material fact by one with a duty to disclose"). The obligation to comply with the disclosure requirements contained in Item 303 can, however, create such a duty, one element of a fraud claim.[9]

Under any commonly accepted meaning, the obligation to provide the information mandated in Item 303 for inclusion in periodic reports can create a "duty" to disclose. The established understanding of the duty to disclose has long been accepted by Congress[10] and

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[9] Plaintiffs will still need to sufficiently allege the other elements of a fraud action, including materiality and scienter. *See Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 100-03 (2d Cir. 2015).

[10] Congress, in adopting the Private Securities Litigation Reform Act in 1995 ("PSLRA"), understood that misrepresentation claims could be based upon the omission of required disclosure. In the PSLRA, Congress amended Section 12 of the 1933 Act by providing an affirmative defense for loss causation. *See* Pub. L. No. 104-67, 109 Stat. 737, tit. 1, §105 (1995) (Section 105 of the PSLRA, codified at 15 U.S.C. §77l(b)).The defense applied to actions "described in subsection (a)(2)" where liability was premised upon the omission of a material fact "required to be stated therein. . . ." 15 U.S.C. §77l(b). Moreover, the legislative history noted that the additional language did not "deprive investors of Section 12(2) remedies when they have incurred losses caused by *inadequate disclosure*." S. Rep. No. 104-98, 104th Cong., 1st Sess. 23 (June 19, 1995). The defense applies to actions "described in subsection (a)(2)" in which liability is premised upon the omission of a material fact "required to be stated therein. . . ." 15 U.S.C. §77l(b). The language suggests that, in adopting Section 12(b), Congress understood that actions under Section 12(a)(2) could be based upon the omission of required disclosure. Given the substantially identical language in Section 12(a)(2) and Rule

acknowledged by academics in their scholarly work and teaching.[11] State courts have broadly recognized a duty to disclose when there is a legal obligation imposed by regulation or statute. The interpretation of the term "duty" to include an obligation to disclose information legally required by a specific regulatory directive is also informed by, and consistent with, the common law.[12] Violations may also contravene the fiduciary duties of officers and directors under state corporate law.[13]

Moreover, the Commission has consistently taken the position that required disclosure in periodic reports creates a duty to disclose. The Commission has done so through interpretation, litigation,[14] and in connection with rulemaking.[15] The efficacy of the federal

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10b-5(b), the same understanding presumably applies to actions under Rule 10b-5(b).

[11] *See* Leidos Brief for Law and Business Professors, *supra* note 2, at 10 (setting forth scholarly authorities supporting).

[12] Authority for this paragraph can be found at: Leidos Brief for Law and Business Professors, *supra* note 2, at 13-16.

[13] The deliberate decision to contravene a legal obligation violates the fiduciary obligations of officers and directors. *See In re Massey Energy Co. Deriv. & Class Action Litig.*, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011).

[14] *See In re GTT Communications, Inc.*, Exchange Act Release No. 98,491, *2 (Admin. Proc. Sept. 25, 2023); *see also In re HP Inc*., Exchange Act Release No. 90,060, *8 (Admin. Proc. Sept. 30, 2020) (alleged violations of Section 17(a) of the 1933 Act for failure to "disclose the known trend of increased quarter-end discounting").

[15] Authority for this paragraph can be found at: Leidos Brief for Law and Business Professors, *supra* note 2, at 12.

system of securities regulation is in fact built on the expectation of legal compliance with, and the public and private enforcement of, these requirements. The failure to do so can have significant consequences, including substantial fines, director bars from serving on corporate boards,[16] and even criminal prosecutions.[17]

Petitioners mostly seek to avoid this result by pointing to language in Section 11 of the 1933 Act. That provision makes actionable the omission of a material fact "required to be stated" in an effective registration statement. 15 U.S.C. §77k(a). Because Rule 10b-5 does not include the same language, Petitioners contend that an omission of S.E.C.-required disclosure cannot be the basis for an action under the Rule. Petitioners' argument is misplaced; they fail to take into account the fundamental differences between the provisions.

As this Court has recognized, liability provisions in the federal securities laws must be examined on a "particularized basis." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200 (1976). Section 11 varies significantly from other liability provisions, including Section 10(b) and Rule 10b-5, both in purpose and scope.

Section 11 provides for civil liability in the narrow context of misstatements and omissions in effective registration statements. 15 U.S.C. §77k. The registration statement is central to the structure of the 1933 Act. Considered to be of "basic importance," registration

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[16] Section 21(d)(2), 15 U.S.C. §78u(d)(2).

[17] *See United States v. Dixon*, 536 F.2d 1388, 1395 (2d Cir. 1976).

statements were intended to be a critical "source of information to the prospective buyer. . . ."[18] Concerned that investors would not obtain the information of the type they needed,[19] Congress put in place a comprehensive and detailed set of requirements defining what would be included in registration statements.[20] *See* 15 U.S.C. §77g.

Seen in this context, actions for omissions of material facts "required to be stated" were designed for a precise purpose. With Congress having determined the material facts that would be given to purchasers in a registered offering, Section 11 made clear that their omission from the registration statement would be actionable, even absent manipulation or deception.[21]

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[18] H.R. Rep. No. 85, 73rd Cong., 1st Sess., at 7 (May 4, 1933) [hereinafter "H.R. Rep. No. 85"].

[19] H.R. Rep. No. 85, *supra* note 18, at 7 ("To assure the necessary knowledge for judgment, the bill requires enumerated definite statements. Mere general power to require such information as the Commission might deem advisable would lead to evasions, laxities, and powerful demands for administrative discriminations.").

[20] H.R. Rep. No. 85, *supra* note 18, at 4 ("The type of information required to be disclosed is of a character comparable to that demanded by competent bankers from their borrowers, and has been worked out in the light of these and other requirements. They are, in the judgment of your committee, adequate to bring into the full glare of publicity those elements of real and unreal values which may lie behind a security.").

[21] E. Merrick Dodd, Jr., *Amending the Securities Act—The American Bar Association Committee's Proposals*, 45 YALE L. J. 199, 216 (1935) ("except in cases in which the Securities and Exchange Commission requires the inclusion in the registration statement of additional information not contained in Schedule A,

Section 11, then, is not premised on fraud unlike Section 10(b) and Rule 10b-5. Instead, it is narrowly tailored to permit "the accurate judgment" on the "value of a security."[22]

Section 10(b) in the Exchange Act and Rule 10b-5(b), on the other hand, were far broader and were premised on fraud and deception. With these antifraud provisions viewed by this Court as part of "an arsenal of flexible enforcement powers", *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976), Section 10(b) and Rule 10b-5(b) are not limited to a particular document or transaction. Instead, as "catch-all" antifraud provisions, they prohibit misleading disclosure in connection with the purchase or sale of any security.

Nothing in the language, approach or context suggests that Congress intended to use Section 11 as a model for Section 10(b) or Rule 10b-5 or otherwise allow Section 11 to effectively limit the broad reach or the longstanding understanding of the antifraud provisions.[23] Moreover, the goal of ensuring the

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the omission of any fact required to be stated means the omission of some fact which Congress has specifically declared to be one about which investors are entitled to be informed.").

[22] H.R. Rep. No. 85, *supra* note 18, at 3 ("The items required to be disclosed, set forth in detailed form, are items indispensable to any accurate judgment upon the value of the security.").

[23] This Court has recognized the independent nature of the two provisions. *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 386 (1983) ("The effectiveness of the broad proscription against fraud in §10(b) would be undermined if its scope were restricted by the existence of an express remedy under §11.").

completeness of registration statements is far different from the goal of prohibiting fraud.[24]

B. The Existence of a Duty to Disclose Information Required by Item 303 is Consistent with, and Compelled by, this Court's Reasoning in *Omnicare*

This Court's reasoning in *Omnicare* supports—even compels—a finding that omissions of disclosure required in Item 303 can be actionable under Rule 10b-5(b).[25]

In *Omnicare*, this Court addressed the potential for omissions to mislead in the context of opinions and beliefs by focusing on the expectations of reasonable investors. Investors could "understand an opinion statement to convey facts about how the speaker has formed the opinion—or, otherwise put, about the

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[24] Petitioners also point to Section 18 and note that "does not explicitly refer to omissions at all. . . ." Brief for Petitioners, at 30. The legislative history indicates that an express reference to omission was viewed as surplusage given the presence of the term "misleading" in the Section. *See Conference Report, Securities Exchange Act of 1934*, H.R. Rep. No. 1838, at 36 (May 31, 1934) ("The Senate amendment also expressly provides that a statement shall be construed to include any omission to state a material fact, and this provision is omitted from the substitute as surplusage in view of the fact that a statement obviously may be misleading because of a material omission.").

[25] *Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, et al*., 575 U.S. 175 (2015). The only circuit to squarely reject the duty to disclose for violations of Item 303 of Regulation S-K did so before this Court's decision in *Omnicare*. *See In re Nvidia Corp., Sec. Litig.*, 768 F.3d 1046 (9th Cir. 2014).

speaker's basis for holding that view." 575 U.S. at 188. To the extent that undisclosed material facts supporting the opinion were not what reasonable investors expected, the stated opinion would "mislead its audience." *Id.*

As this Court noted in *Omnicare*, reasonable investors do not "expect that *every* fact" omitted from an opinion misleads. *Id.* at 190 (emphasis in original). Instead, expectations depend upon "context." Context includes such factors as the document where the omission occurred (applying the approach to "formal documents" that are "filed with the SEC as a legal perquisite") and the "surrounding text." *Id.* at 190-91. Moreover, the "principles are not unique to §11" but "inhere, too, in much common law respecting the tort of misrepresentation." *Id.* at 191.

With respect to trend disclosure, reasonable investors can expect that information required to be disclosed by Item 303 will in fact appear in periodic reports. Where such disclosure is not made, the omissions can "mislead its audience." *Id.* at 188. This is the case for a number of reasons.

First, the inclusion of disclosure required in Item 303 is uniquely important to investors. The S.E.C. has characterized the provision as a "critical component" in management's communications with investors.[26]

[26] *Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, Exchange Act Release No. 48,960, 68 Fed. Reg. 75055, *1 (Dec. 29, 2003) [hereinafter "Exchange Act Release No. 48,960"].

MD&A has been described as the "keystone" to the system of periodic reporting,[27] with trend disclosure considered "[o]ne of the most important elements necessary to an understanding of a company's performance."[28]

This is the case for good reason. Much of the disclosure in Item 303 arose out of the recognition that a disclosure regime based entirely upon historical fact often failed to meet the needs of investors.[29] While investors were primarily "future oriented,"[30] historical

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[27] Linda Quinn, Dir., Div. of Corp. Fin., *Statement at The Roundtable on the Integration of The 1933 and 1934 Acts*, S.E.C. Historical Society, William O. Douglas Open Meeting Room, U.S. Securities and Exchange Commission Washington, D.C., March 21, 2002, at 96 (Mar. 21, 2002) (statement by former director, Division of Corporation Finance, SEC), *available at* https://www.sechistorical.org/collection/programs/int1933_1934Transcript.pdf; *see also Accounting and Investor Protection Issues Raised by Enron and Other Public Companies*: Before the United States Senate Committee on Banking, Housing, and Urban Affairs, 107th Congress (2002) (Statement of Harvey L. Pitt, Chairman, S.E.C. on Mar. 21, 2002) (describing MD&A as the "backbone of a company's disclosures"), *available at* https://www.sec.gov/news/testimony/032102tshlp.htm.

[28] Exchange Act Release No. 48,960, *supra* note 26, at *10.

[29] Homer Kripke, *A Search for a Meaningful Securities Disclosure Policy*, 31 Bus. Law. 293, 315 (1975) (noting that efforts by the S.E.C. in MD&A represented a departure "from the hard concept that only the past is factual, and is requiring disclosures oriented to the future").

[30] *Proposed Guides for Disclosure of Projections of Future Economic Performance*, Exchange Act Release No. 12,371, 41 Fed. Reg. 19986, *2 n. 3 (1976).

facts were not necessarily "indicative of current or future operations or earnings."[31]

MD&A disclosures required by Item 303 were structured to address these concerns. The disclosure of trends and uncertainties provides insight into a company's "future prospects,"[32] whether favorable or unfavorable.[33] They amount to an early warning system that can foreshadow material developments and unwanted surprises.[34] At the same time, disclosure is made "through the eyes of management,"[35] revealing

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[31] 17 C.F.R. §229.303(a) ("The discussion and analysis must focus specifically on material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.").

[32] *See Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information*, Exchange Act Release No. 90,459, 86 Fed. Reg. 2080, *13 (Nov. 19, 2020) [hereinafter "Exchange Act Release No. 90,459"].

[33] *Guidelines for Registration and Reporting*, Exchange Act Release No. 10,961, 39 Fed. Reg. 31894, 31895 (Sept. 3, 1974).

[34] *Commission Guidance on Presentation of Liquidity and Capital Resources Disclosures in Management's Discussion and Analysis*, Exchange Act Release No. 62,934, 75 Fed. Reg. 59894, *4 (Sept. 17, 2010).

[35] Exchange Act Release No. 48,960, *supra* note 26, at *8.

what is "currently known"[36] and already available to the company.[37]

Second, investor expectations that trends will appear in periodic reports when required are reinforced by the presence of a robust system of "disclosure controls" intended to ensure that this occurs. *See* Rule 13a-15(a), 17 C.F.R. §240.13a-15(a). Mandated by Congress in the Sarbanes-Oxley Act of 2002, Section 404, Pub. L. No. 107-204, 116 Stat. 745, these controls are "designed to ensure that information required by an issuer" is "recorded, processed, summarized, and reported within the time periods specified in the Commission's rules and forms."[38]

This is not a perfunctory obligation. Issuers must evaluate the system on a quarterly basis, with mandatory participation by the chief executive officer and chief financial officer, Rule 13a-15(b), 17 C.F.R.

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[36] *Concept Release on Management's Discussion and Analysis of Financial Condition and Operations*, Exchange Act Release No. 24,356, 52 Fed. Reg. 13715, *4 (April 17, 1987). Examples include: "A reduction in the registrant's product prices; erosion in the registrant's market share; changes in insurance coverage; or the likely non-renewal of a material contract." *Id.*

[37] Mitu Gulati, *When Corporate Managers Fear a Good Thing Is Coming to an End: The Case of Interim Nondisclosure*, 46 UCLA L. Rev. 675, 703 (1999) ("Companies that have not processed their information, and hence do not know that there is a material trend or uncertainty, are not obligated to disclose—their obligation is merely to collect the information and process it within the time specified by the SEC. Therefore, the obligation under Item 303 attaches to companies who, for reasons independent of the SEC's requirements, have produced information.") [hereinafter "Gulati"].

[38] *In re Newell Brands, Inc.*, Exchange Act Release No. 98,629, *10 (Admin. Proc. Sept. 29, 2023).

§240.13a-15(b),[39] and make the results public. *See* Item 9(a) of Form 10-K; Item 4 of Item 10-Q; *see also* Item 307 of Regulation S-K, 17 C.F.R. §229.307. These mechanisms are important to the production of accurate and complete disclosures, including those required by Item 303, with lax compliance discouraged through rigorous enforcement.[40]

The expectations of reasonable investors, as this Court specified in *Omnicare*, depend upon context. 575 U.S. at 190. In this case, the formal nature of the documents (periodic reports), the centrality of Item 303 to the mandatory disclosure process, and the over-arching requirement of robust disclosure controls that are regularly evaluated, taken together, are sufficient to allege that reasonable investors expected the disclosure of material trends and uncertainties concerning the adverse impact of the regulation put in place by the International Maritime Organization governing the sulfur content of fuel oil ("IMO 2020") and that the omission of such disclosure could be misleading. The result is further compelled by the "widely reported" nature of IMO 2020. *See* Brief for Petitioners, at 11.

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[39] Under Rule 13a-14(a), quarterly and annual reports must include a certification for the principal executive and principal financial officer. 17 C.F.R. §240.13a-14. The certificate requires a representation that they are "responsible for establishing and maintaining disclosure controls[.]" Item 601(b)(31)(i), 17 C.F.R. §229.601(b)(31)(i).

[40] *See* §6.04 Disclosure Controls and Procedures, J. ROBERT BROWN, JR., THE REGULATION OF CORPORATE DISCLOSURE (4th ed. 2016; updated annually).

C. The Failure to Reaffirm that Disclosure Requirements Contained in Item 303 can give rise to an Action under Rule 10b-5 will Weaken Enforcement and Result in Disclosure that does not Meet the Expectations of Reasonable Investors

Failure to reaffirm that omissions of disclosure required in the MD&A are actionable under Section 10(b) and Rule 10b-5 will impair efforts to ensure adequate compliance with the requirements of Item 303.

Concerns have sometimes arisen over the quality and completeness of the disclosure produced in the MD&A.[41] In making a facts-and-circumstances determination about whether trends are "reasonably likely" to affect business operations or financial conditions, management can get the analysis wrong.[42] Relevant officials may decide that a known trend will not have a material impact on operations when in fact it can and does. In some cases, companies may engage in "strategic nondisclosure," effectively balancing the perceived harm of disclosure against the risk of liability.[43]

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[41] The litany of problems and concerns with MD&A are discussed here: Leidos Brief for Law and Business Professors, *supra* note 2, at 25-26.

[42] For a discussion of the benefits of non-disclosure of adverse developments, *see* J. Robert Brown, Jr. and Eli Wald, *Chilling Climate Change Disclosure: The Enabling Role of Corporate Counsel in Management Misstatements of ESG Matters*, 72 DEPAUL L. REV. 585, 600-01 (2023) [hereinafter "Brown & Wald"].

[43] *See* George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 TUL. L. REV. 639 (2021) ("The decision whether or not to disclose information is binary by

In either case, the difficulty in detecting omissions can weigh in favor of nondisclosure.[44] And while counsel may review management's determination, they may not be wholly familiar with, or informed of, the bases for that determination or may be subject to a confirmation bias.[45]

Although describing the purpose of the MD&A as "not complicated," see Exchange Act Release No. 48,960, *supra*, *2, the Commission has engaged in significant effort and expended substantial resources to ensure the quality and completeness of the disclosure, including enforcement actions.[46] As recently as 2020, the Commission amended Item 303, observing that "the quality of analysis in MD&A could be improved"

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necessity, but materiality itself is not–it often exists in a gray, probabilistic space where an argument can be made both that something is material and that it is not. In practice, this means that in many cases the disclosure decision is not the result of a conclusive finding of materiality, but, rather, of the weighing of the costs of disclosure against the risk of liability for non-disclosure.").

[44] With respect to affirmative statements, investors are in a position to investigate accuracy. They can, for example, seek additional information from the company through the use of inspection rights under state law. *See* 8 Del. C. §220. In the case of nondisclosure, however, investors would often remain entirely unaware of the matter. Further investigation would not, therefore, be possible.

[45] Brown & Wald, *supra* note 42, at 589-91.

[46] *See* Leidos Brief for Law and Business Professors, *supra* note 2, at 24 (discussing S.E.C. efforts to improve disclosure quality in MD&A).

and implementing changes designed in part to bring additional "clarity and focus" to the disclosure.[47]

The failure to reaffirm that omissions of required disclosure under Item 303 are actionable under Rule 10b-5 will limit private enforcement, reducing the number of actions for intentional disclosure violations.[48] The failure will also, contrary to the position of Petitioners, "hamper" the Commission's ability to ensure compliance with Item 303. Brief for Petitioners, at 3. Without the availability of Rule 10b-5, enforcement by the Commission for omissions of disclosure required by Item 303 will largely be limited to actions under Section 13(a) of the Exchange Act. 15 U.S.C. §78m(a).[49]

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[47] Exchange Act Release No. 90,459, *supra* note 32, at *12 & *14.

[48] Empirical evidence suggests that private parties are more likely to pursue intentional disclosure violations. Stephen Choi & Adam C. Pritchard, *S.E.C. Investigations and Securities Class Actions: An Empirical Comparison*, 13 J. EMPIRICAL LEGAL STUD. 27, 47 (2016) ("Overall, the evidence presented here does not suggest that S.E.C. enforcement is more precisely targeted than class actions. Our results suggest that private plaintiffs' attorneys, if anything, are more likely to pursue intentional disclosure violations compared to the S.E.C. From a policy perspective, our findings offer little support to commentators who call for a shift from private actions to greater public enforcement.").

[49] The absence of a duty to disclose may impact the S.E.C.'s enforcement authority under other provisions of the federal securities laws. Rule 10b-5(b) and Section 17(a)(2) of the 1933 Act use similar language. *See Walck v. Am. Stock Exch.*, 687 F.2d 778, 789 n. 16 (3d Cir. 1982). Moreover, the decision may also narrow enforcement by state regulators. Section 501 of the Uniform Securities Act of 2002 includes a prohibition on securities fraud. The provision is "modeled on Rule 10b-5 adopted under the Securities

Reliance on Section 13(a) as the primary means of addressing omissions from periodic reports will be inadequate for a number of reasons. The provision is not designed to compensate investors for their losses.[50] Moreover, without the possibility of a claim under Rule 10b-5(b), the number of actions brought by the Commission for omitted disclosure will likely decline. The Commission has limited resources and cannot conduct every possible investigation or bring every viable case.[51] Public enforcement, therefore, necessarily reflects agency priorities. Deterrence of fraud represents a key priority.[52]

Compared with proceeding under Section 13(a), Commission actions for fraud under Rule 10b-5(b) provide far greater deterrence. Such fraud claims can

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Exchange Act of 1934 and on Section 17(a) of the Securities Act of 1933." Uniform Securities Act §501 cmt. 1 (amended 2002). Given the overlap in language, state courts may defer to and rely on federal interpretations. *See* Adam J. Gana & Michael Villacres, *Blue Skies for America in the Securities Industry . . . Except for New York: New York's Martin Act and the Private Right of Action*, 19 FORDHAM J. CORP. & FIN. L. 587, 591 (2014).

[50] Investors seek damages. The Commission generally seeks disgorgement. Disgorgement focuses on depriving wrongdoers of their profits. *See Liu v. Securities and Exchange Commission*, 140 S. Ct. 1936 (2020).

[51] *See* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L. J. 923, 964-65 (2019).

[52] *See Summary of Performance and Financial Information, U.S. Securities and Exchange Commission*, Fiscal Year 2016, at 4 ("Comprehensive, accurate, and reliable financial reporting is the bedrock upon which our markets are based. Because of this, rooting out financial and disclosure fraud must be a priority for the Division of Enforcement (Enforcement)—and FY 2016 was no exception.").

include an officer and director bar, *see* Section 21(d)(2), 15 U.S.C. §78u(d)(2), a particularly "feared" remedy. *See* Luis Aguilar, Comm'r, SEC, Speech at the Securities Enforcement Forum 2012: *Taking a No-Nonsense Approach to Enforcing the Federal Securities Laws* (Oct. 18, 2012). Actions for fraud also can render unavailable safe harbors for the private placement of shares and forward-looking information, *see* Section 21E(b)(1), 15 U.S.C. §78u-5(b)(1), or certain exemptions from the registration requirements in the 1933 Act. *See* Rule 506(d)(1)(v), 17 C.F.R. §230.506(d)(1)(v).

Individuals in fraud actions can be charged as primary violators.[53] Moreover, unlike Section 13(a), violations under Rule 10b-5 sound in fraud and require allegations of scienter. Both increase the perceived seriousness of the offense and enhance deterrence through greater risk of reputational consequences. *See* Christopher F. Baum, James G. Bohn, & Atreya Chakraborty, *Securities Fraud and Corporate Board Turnover: New Evidence from Lawsuit Outcomes*, 48 INT'L REV. OF L. & ECON. 14, 16 (2016) (discussing literature indicating that filing of fraud actions can have a "negative impact on CEO careers").

[53] An individual can be a primary violator of Rule 10b-5(b) to the extent qualifying as a "maker" of the false statement. *See Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135, 142 (2011). At least one opinion has suggested that individuals may not be charged as primary violators under Section 13(a). *See S.E.C. v. Jensen*, 835 F.3d 1100, 1118 (9th Cir. 2016) (Bea, J., concurring to "clarify the intended scope" of the ruling). Individuals can, however, be charged with aiding and abetting violations of Section 13(a). *See S.E.C. v. Todd*, 642 F.3d 1207 (9th Cir. 2011).

The Commission's inability to rely on Rule 10b-5 for omissions of required disclosures would also weaken the ability to negotiate settlements with adequate deterrent effect. Not every settled case that could include claims under Rule 10b-5 for the omission of required disclosure would do so. The possibility of such a claim and the potential harm to a company's reputation, however, can provide leverage in negotiating more meaningful settlements that provide models for others, including improvements in internal controls and governance. That leverage would not be available should Rule 10b-5 be rendered unavailable for omissions of required disclosure.

D. The Reaffirmation that Disclosure Requirements Contained in Item 303 can give rise to an Action under Rule 10b-5 will not Result in Information Overload; to the Extent Additional Disclosure Occurs, it will Benefit Investors

Because Item 303 disclosures arise only for *known* conditions, these disclosures do not entail costs related to identifying, searching for, or detecting the condition. Moreover, the reaffirmation that omissions of required disclosure under Item 303 are actionable under Rule 10b-5 will not result in "information overload" that effectively overwhelms investors. This assertion rests on a mistaken view of the equity markets and the methods used by investors to access and absorb information provided by public companies.

Equity markets are dominated by institutional investors.[54] Individuals mostly invest in the markets indirectly through these types of investors and therefore commonly rely on them to access and analyze information disclosed by public companies.[55] Analysis of disclosure in periodic reports is commonly driven by technology,[56] with these reports accessed electronically and data increasingly filed in a machine-readable format,[57] facilitating analysis "across time periods, across companies, and even between data in S.E.C. filings and other agency filings."[58]

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[54] Jeff Schwartz, *Stewardship Theater*, 100 WASH. U. L. REV. 393, 406 (2022).

[55] James Fallows Tierney, *Investment Games*, 72 DUKE L. J. 353, 373 (2022).

[56] *FASB In Focus*, XBRL, Who Uses XBRL?, *last visited* Dec. 11, 2023 ("Machines represent over 95% of EDGAR 'visitors' enabling a wide range of XBRL data users, including investors, financial analysts, economic research firms, data aggregators, academic researchers, college professors, preparers for peer analysis, auditors, the SEC, FDIC, IRS, and other federal agencies, as well as the FASB.").

[57] *See Listing Standards for Recovery of Erroneously Awarded Compensation*, Exchange Act Release No. 96,159, 87 Fed. Reg. 73076,*49 (Oct. 26, 2022) ("[R]equiring Inline XBRL tagging of the compensation recovery disclosure benefits investors by making the disclosures more readily available and easily accessible to investors, market participants, and others for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine readable data language such as ASCII or HTML.").

[58] Allison Herren Lee, Commissioner, SEC, *The Promise of Structured Data: True Modernization of Disclosure Effectiveness*, XBRL User Forum, Nov. 17, 2020. *See also Pay Versus Performance*, Exchange Act Release No. 95,607, 87 Fed. Reg. 55134, *12 (Aug. 25, 2022).

In this environment, there is no realistic likelihood that additional disclosure of trends will overwhelm with excessive detail the sizable group of informed investors who are critical to price formation. Indeed, investors have consistently sought more granular disclosure from public companies.[59] Additional disclosures, if any, that result from a reaffirmation that omissions of matters required by Item 303 are actionable under Rule 10b-5 will have little or no impact on the ability of the market to efficiently and, in a cost-effective manner, absorb the information.

Regardless, any increase in responsive disclosure of the sort mandated by Item 303 will benefit investors. MD&A has been viewed as particularly significant to investors. Item 303 was promulgated to enhance the utility of information to investors by moving disclosures beyond historical performance. Trend information assists investors in engaging in appropriate risk assessment. Additional disclosure of this type of information provides greater insight into the future direction of a company's finances or operations and alerts investors to conditions and trends that management believes can have a reasonable likelihood of a

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[59] The Financial Accounting Standards Board (FASB), for example, has under consideration a proposal to provide greater detail in the financial statements by disaggregating the expense data currently included. *See Proposed Accounting Standards Update—Income Statement—Reporting Comprehensive Income—Expense Disaggregation Disclosures (Subtopic 220-40)—Disaggregation of Income Statement Expenses*, FASB, July 31, 2023. Investors strongly support additional disaggregation of the financial statements. *See* Letter to Technical Director, FASB, from J. Robert Brown, Jr., re: File Reference No. 2023-ED500, Oct. 30, 2023.

material impact on operations that would not be discerned merely from disclosure of historical performance.

CONCLUSION

We believe that the failure to reaffirm that the disclosure requirements contained in Item 303 can give rise to an action under Rule 10b-5, a provision adopted by S.E.C. rulemaking under explicit congressional authorization, will weaken investor confidence in the system of periodic reporting.[60] The failure will essentially amount to the imposition of a bright-line test that eliminates the need to consider whether the omission of trends and uncertainties under Item 303 in fact will "mislead its audience."[61]

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[60] *See* Gulati, *supra* note 37, at 703 ("The combination of nonverifiability and a significant risk that the company has undisclosed negative interim information creates a 'lemons' problems. A lemons problem occurs when investors cannot distinguish between truthful issuers and those that are hiding information."). For a discussion of existing investor concerns over the SEC's system of disclosure, *see* J. Robert Brown, Jr., *Essay: Mother Nature on the Run: The SEC, Climate Change Disclosure, and the Major Questions Doctrine*, 60 SAN DIEGO L. REV. 321, 369-71 (2023).

[61] This Court has rejected that approach in other contexts. *See Basic v. Levinson*, 485 U.S. 224 236 (1988) (noting that a "bright-line rule" for a fact-specific finding "must necessarily be overinclusive or under-inclusive"); *see also Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 40 (2011) (describing argument for a "bright-line" test for adverse event reports as "flawed").

For these reasons, *amici* respectfully urge this Honorable Court to find that under the allegations contained in this case, Item 303 imposed a duty to disclose actionable under Section 10(b) and Rule 10b-5(b) and affirm the ruling of the United States Court of Appeals for the Second Circuit.

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