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SCOTUS to Hear Dispute Over SEC Disclosure Rules

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The U.S. Supreme Court agreed to hear a case this term involving the circuit split over the types of disclosures that private plaintiffs can enforce under Section 10(b) of the Securities Exchange Act of 1934. Section 10(b) prohibits deception in connection with the purchase or sale of securities, and is the primary statutory basis that private plaintiffs use to sue companies and their officers and directors for misleading statements.

The issue here is the relationship between Section 10(b) and Item 303 of the Securities and Exchange Commission's (SEC) Regulation S-K, which requires companies to disclose trends or uncertainties that are likely to have material impact on a company's financial position.

Specifically, the dispute concerns whether the failure to make a disclosure under Item 303, without an affirmative misleading statement, is a sufficient basis for a private cause of action under Section 10(b).

The case before the Court involves a class action suit with lead plaintiff Moab Partners against Macquarie Infrastructure. The investors alleged that Macquarie executives concealed the extent to which their bottom line could be impacted by a new environmental regulation.

The investors brought this claim as a class action pursuant to Section 10(b). They argued that Macquarie's alleged concealment was the equivalent of an affirmative misleading statement, such that they can bring suit under Section 10(b).

Macquarie countered that, while the potential impact of the new environmental regulation may have been a required disclosure under Item 303, the failure to disclose under Item 303 cannot serve as a basis for a private action under Section 10(b).

Macquarie further argued that, by allowing an Item 303 violation to serve as the premise for a Section 10(b) claim, the Second Circuit eliminated the fraudulent intent requirement of Section 10(b), which requires that defendants have acted with scienter — a state of mind embracing intent to deceive, manipulate, or defraud.

The lawsuit against Macquarie was initially dismissed in 2021 by a New York District Court judge who, agreeing with Macquarie, found that the lead plaintiff had failed to identify any corporate statements to investors that would be actionable as misleading.

While the Second Circuit agreed that most of the company's statements were nonactionable under Section 10(b), it held that Macquarie's alleged omissions about the possible financial effects of the new regulation provided

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enough basis for the plaintiffs to avoid dismissal.

The Second Circuit is the only circuit court that has found that omissions of Item 303 disclosures, without any affirmative statement, could serve as the basis for private actions under Section 10(b). The Third, Ninth, and Eleventh Circuits have previously rejected this position and have all held that only untrue or misleading statements are grounds for Section 10(b) liability and, thus, allegedly omitted disclosures under Item 303 do not give rise to a cause of action under Section 10(b). The Fifth Circuit similarly has rejected the Second Circuit's approach, having never held that Item 303 creates a duty to disclose.

The Second Circuit's departure from its sister circuits began in 2015 when in *Stratte-McClure v. Morgan Stanley*, it held that the failure to make a required disclosure under Item 303 could be the basis of a securities fraud claim under Section 10(b). The court concluded that financial statements could be rendered misleading through omissions of known trends or uncertainties that could foreseeably cause material adverse effects. In *Stratte*, however, the Second Circuit ultimately affirmed dismissal of the plaintiffs' case on the ground that the plaintiffs had failed to demonstrate the defendants' intent to mislead investors about material facts.

The U.S. Supreme Court previously granted review of another case on this topic in 2017, *Leidos, Inc. v. Indiana Public Retirement System*, 580 U.S. 1216 (2017), but the case settled before argument.

If the Supreme Court were to adopt the Second Circuit's interpretation, it would expand private securities liability since it would allow not only for private suits based on affirmative untrue or misleading statements, but also would allow for suits premised on the lack of information required by Item 303. This expansion will only increase a notable existing trend of corporate overdisclosure, which creates unnecessary costs and decreases the utility of corporate filings.

The case, *Macquarie Infrastructure Corp. et al. v. Moab Partners LP et al*., number 22-1165, will be argued before the U.S. Supreme Court in January or February 2024 with a decision to follow by summer 2024.

Alyssa Cavanaugh also contributed to this article. She is not licensed to practice law in any jurisdiction; application pending for admission to the Georgia Bar.

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