

US Supreme Court Limits Scope of Omission Liability for Section 10(b) Securities Fraud Claims

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On April 12, in a long-awaited and pivotal decision, the U.S. Supreme Court unanimously ruled that private plaintiffs may not plead a federal securities fraud claim under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) based solely on a company's failure to disclose a known trend or uncertainty required to be disclosed under Item 303 of the U.S. Securities and Exchange Commission (SEC) Regulation S-K.^[1]

The issue at hand was the relationship between Section 10(b) of the Exchange Act and Item 303 of SEC Regulation S-K. Section 10(b) prohibits the use of any manipulative or deceptive device or contrivance "in connection with the purchase or sale of any security."^[2] By way of background, Rule 10b-5 implements this prohibition, making it unlawful for issuers to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."^[3] This judicially created private right of action allows plaintiffs to seek recovery for Rule 10b-5 violations. Separately, Item 303 of SEC Regulation S-K requires issuers to describe any known trends or uncertainties that are likely to have a material impact on a company's financial position.^[4] There is no separate private right of action under Item 303. As a result, plaintiffs seeking recourse for alleged Item 303 violations utilize Section 10(b) and Rule 10b-5 as a primary mechanism to bring a lawsuit against the issuer.

In the underlying suit in the U.S. District Court for Southern District of New York, shareholders brought a putative class action against Macquarie Infrastructure Corp. (Macquarie) alleging a violation of Section 10(b) of the Exchange Act and Rule 10b-5 based on Macquarie's failure to make a disclosure under Item 303. The premise of the plaintiffs' argument was that Macquarie's Item 303 disclosures were false and misleading because they omitted that its subsidiary's largest product faced a ban on most of its worldwide use through a new environmental regulation. In the plaintiffs' view, Macquarie had a duty to disclose the extent to which it could be impacted by the new regulation, and by not doing so, purportedly violated its disclosure obligations under Item 303 and, therefore, violated Section 10(b) and Rule 10b-5.

The district court dismissed the suit, finding that the plaintiffs failed to allege an Item 303 violation because they failed to identify an uncertainty that should have been disclosed.^[5] That court noted that it was not necessary to reach the question of a Section 10(b) violation. The U.S. Court of Appeals for the Second Circuit reversed, holding that the plaintiffs adequately alleged an Item 303 violation and that the Item 303 violation alone could sustain their Section 10(b) and Rule 10b-5 claim.^[6] Unlike the Second Circuit, the Third, Ninth, and Eleventh Circuits have rejected this position, reasoning that only omissions that render other statements made as untrue or misleading are grounds for Section 10(b) liability and, thus, allegedly omitted disclosures under Item 303 alone do not give rise to a cause of action under Section 10(b).^[7]

The US Supreme Court Ruling

The question before the U.S. Supreme Court was whether the failure to disclose information required by Item 303 can support a private action under Rule 10b-5(b), even if the failure does not render any “statements made” misleading. The Court held that it cannot, making clear that pure omissions are not actionable under Rule 10b-5.

The Court began its analysis by emphasizing the distinction between “pure omissions” and “half-truths” in securities litigation.^[8] The Court explained that a pure omission occurs when a speaker says nothing, in circumstances that do not give any special significance to that silence.^[9] Half-truths, on the other hand, are “representations that state the truth only so far as it goes, while omitting critical qualifying information.”^[10] Rule 10b-5 requires disclosure of information necessary to ensure that the statements already made are clear and complete. The Court concluded, therefore, that Rule 10b-5 covers half-truths, not pure omissions, because it requires identifying affirmative assertions (*i.e.*, “statements made”) before determining if other facts are needed to make those statements “not misleading.”^[11]

The Court also found that, while Section 11(a) of the Securities Act — which prohibits material omissions in registration statements — by its own terms creates a liability for failure to speak, neither Section 10(b) nor Rule 10b-5 contain comparable language.^[12]

The Court addressed the plaintiffs’ argument that they need not plead any statements rendered misleading by a pure omission since reasonable investors know that Item 303 requires disclosure of all known trends and uncertainties.^[13] It found that the plaintiffs’ argument fails because it reads the words “statements made” out of Rule 10b-5 and would improperly shift the focus of Rule 10b-5 and Section 10(b) from fraud to disclosure.^[14] Additionally, the Court noted that the plaintiffs’ argument would render Section 11(a)’s pure omission clause superfluous by transforming every omission of a fact “required to be stated” into a misleading half-truth.^[15]

The Court also rejected the plaintiffs’ argument that, without private liability for pure omissions under Rule 10b-5, there will be “broad immunity any time an issuer fraudulently omits information Congress and the SEC require it to disclose.”^[16] The Court clarified that private parties remain free to bring claims based on Item 303 violations that create misleading half-truths, and the SEC retains authority to prosecute violations of its own rules and regulations, including Item 303.^[17]

Implications

The Supreme Court’s ruling has important ramifications for litigants in federal securities class actions. For one thing, it narrows the scope of potential liability for defendants, as it limits the circumstances under which a failure to disclose under Item 303 can give rise to a federal securities fraud claim. Additionally, the ruling should result in fewer securities class actions based solely on Item 303 violations, as plaintiffs will now need to identify specific misleading statements that were rendered more misleading by the omission in order to adequately plead a claim. This could potentially reduce the risk of securities litigation for companies, particularly those subject to significant regulatory disclosure requirements.

However, the Court’s decision does not entirely insulate defendants from liability for Item 303 violations. The SEC retains the authority to enforce these disclosure requirements, and private plaintiffs can still bring claims based on

Item 303 violations that create misleading half-truths. Additionally, if a company omits an Item 303 disclosure in the context of a securities offering, such company could be subject to a claim under Section 11 of the Securities Act. Thus, companies must remain diligent in their compliance with these existing disclosure requirements.

[1] *Macquarie Infrastructure Corp. v. Moab Partners, L. P.*, No. 22-1165, 2024 WL 1588706 (U.S. Apr. 12, 2024).

[2] 15 U. S. C. §78j(b).

[3] 17 CFR §240.10b-5(b).

[4] 17 CFR §229.303(b)(2)(ii).

[5] *City of Riviera Beach Gen. Emps. Ret. Sys. v. Macquarie Infrastructure Corp.*, No. 18-CV-3608, 2021 WL 4084572, at *1 (S.D.N.Y. Sept. 7, 2021), *vacated and remanded sub nom. Moab Partners, L.P. v. Macquarie Infrastructure Corp.*, No. 21-2524, 2022 WL 17815767 (2d Cir. Dec. 20, 2022), *vacated and remanded*, No. 22-1165, 2024 WL 1588706 (U.S. Apr. 12, 2024).

[6] *Moab Partners, L.P. v. Macquarie Infrastructure Corp.*, No. 21-2524, 2022 WL 17815767, at *1 (2d Cir. Dec. 20, 2022), *cert. granted*, 144 S. Ct. 479 (2023), *vacated and remanded*, No. 22-1165, 2024 WL 1588706 (U.S. Apr. 12, 2024).

[7] See, e.g., *Oran v. Stafford*, 226 F.3d 275, 287–88 (3d Cir. 2000); *In re NVIDIA Sec. Litig.*, 768 F.3d 1046, 1054–56 (9th Cir. 2014); *Carvelli v. Ocwen Fin. Corp.*, 934 F.3d 1307, 1331 (11th Cir. 2019).

[8] *Macquarie Infrastructure Corp.*, No. 22-1165, 2024 WL 1588706, at *4.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.* at *5.

[13] *Id.*

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.*

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