

[Securities Regulation Daily Wrap Up, TOP STORY—U.S.: Leidos Reg. S-K petition dismissed after parties tell justices of settlement, \(Jun. 20, 2018\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

The Supreme Court dismissed the certiorari petition filed in a case alleging that Leidos, Inc. failed to make necessary disclosures under Regulation S-K. Dismissal had been expected ever since the justices removed the case from the court's calendar last year, but a letter recently filed with the court confirms that a settlement obviates the need for further appeal ([Leidos, Inc. v. Indiana Public Retirement System](#), June 18, 2018).

Known trends. In *Leidos*, the justices would have mulled this question: Does Item 303 of Regulation S-K create a duty to disclose that is actionable under Exchange Act Section 10(b) and Rule 10b-5? The Second Circuit in *Leidos* said a company can be liable for information omitted from disclosures made under Item 303. Petitioner Leidos had asserted a split between the Second Circuit's opinion and two other circuits. In *Oran v. Stafford*, for example, then-Third Circuit Judge (now Justice) Alito, writing for the court, shut the door on Item 303 creating a private cause of action. The [Ninth Circuit](#) has cited *Oran* favorably regarding the different materiality standards under Rule 10b-5 and Item 303.

Item 303(a)(3)(ii) of Regulation S-K is a key part of the flexible analysis contained in a firm's management's discussion and analysis (MD&A) disclosures. The purpose of the MD&A is to allow investors to see the firm through the eyes of its management. Disclosure is required if the registrant reasonably expects a known trend or uncertainty will materially impact its operations. The SEC further explained in an [interpretive release](#) how Item 303 should be applied:

Where a trend, demand, commitment, event or uncertainty is known, management must make two assessments:

1. Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
2. If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event, or uncertainty on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur.

The materiality threshold in Item 303 is often compared to the similar threshold under Exchange Act Section 10(b), Rule 10b-5, and the Supreme Court's opinion in *Basic Inc. v. Levinson*. The several appellate decisions considering the issue have noted these differences.

Will Item 303 question arise again? To underscore the significance of *Leidos*, the Justices had granted the solicitor general's request to appear as amicus and to participate in oral argument just days before deciding to remove *Leidos* from the court's calendar after having previously scheduled oral argument for November 2017.

Less than two weeks before Noel Francisco was sworn in as solicitor general, then-Acting Solicitor General Jeffrey Wall had urged the court to affirm the Second Circuit's holding against Leidos on the ground that the case involved a misleading half-truth rather than a "pure omission" as alleged by Leidos. Leidos had argued in its briefs that it could be liable under Item 303 only if it had stated that its filing included the disclosures required by Item 303. The government, by contrast, argued that this view overlooked the fact that reasonable investors

understand that a company's filings implicitly represent that they include Item 303 disclosures. The government also suggested that a theory based on silence could likewise result in liability.

With respect to concerns that such holding could open the flood gates for private suits over Regulation S-K disclosures, the government said this: "The court of appeals' decision here thus does not give private plaintiffs the practical equivalent of a private cause of action to enforce Item 303 or Regulation S-K. Instead, it provides a critical backstop to prevent unscrupulous issuers from exploiting the trust that reasonable investors place in submissions made in purported compliance with SEC disclosure requirements."

A [letter](#) submitted by the parties to the justices earlier this month had confirmed that the underlying case was to be settled and that the [certiorari petition](#) could be dismissed. Although the dismissal resolves one of the lingering questions about the securities cases mulled by the justices in OT 2017, it leaves open a possible circuit split that may yet get before the court should another similar case arise.

The case is [No. 16-581](#).

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Companies: Leidos, Inc.; Indiana Public Retirement System

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