

## [Securities Regulation Daily Wrap Up, TOP STORY—U.S.: High Court will consider whether Item 303 creates an independent duty to disclose under Section 10\(b\), \(Mar. 27, 2017\)](#)

Securities Regulation Daily Wrap Up

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By [Rodney F. Tonkovic, J.D.](#)

The Supreme Court will hear a case on whether Item 303 of Regulation S-K creates an actionable duty to disclose under the Exchange Act. The petition asks the Court to resolve a split involving a holding by the Second Circuit, which found that Item 303 creates an independent duty to disclose under the antifraud provisions that is in direct conflict with decisions of the Third and Ninth Circuits ([Leidos, Inc. v. Indiana Public Retirement System](#), October 31, 2016).

In 2000, the petitioner, known at the time as SAIC, Inc., became the prime government contractor on a project with New York City to develop and implement an automated timekeeping program for city employees. While the project was underway, two SAIC employees engaged in a kickback scheme with a subcontractor. SAIC and its management were unaware of the scheme until it was uncovered by government investigators in December 2010. In 2011, SAIC timely disclosed in an SEC filing that the city had formally demanded repayment, and the company later entered into a deferred prosecution agreement.

In 2012, investors filed suit alleging that SAIC's statements, including SEC filings, contained false statements and omissions about potential liability related to CityTime. The district court dismissed the complaint for failure to state a claim.

**Actual knowledge required.** On appeal, the [Second Circuit](#) held that SEC failed to make required disclosures under Item 303 in a March 2011 Form 10-K. In the Second Circuit, the failure to make a required Item 303 disclosure is an omission that can serve as the basis for a securities fraud claim under Section 10(b). In this case, the court held specifically that the plain language of Item 303 requires actual knowledge of the relevant trend or uncertainty in order to be liable for failing to disclose it. The court went on to find that the complaint supported a strong inference that SAIC actually knew about the CityTime fraud, and that it could be implicated in the fraud, before filing its Form 10-K. Under these circumstances, the court said, SAIC was required under Item 303 to disclose the expectation of a material impact to its future revenues.

**Circuit Split.** The petition argues that the Second Circuit's holding entrenches a deep circuit split. According to the Second Circuit, the petition explains, a duty to disclose under Section 10(b) can derive from statutes or regulations obliging a party to speak, including Item 303, even if those omissions do not make any affirmative statements misleading. This holding is in direct conflict with [Third](#) and [Ninth](#) Circuit decisions holding that Item 303 does not create an independent duty to disclose for purposes of Section 10(b). The Second Circuit's position is also at odds with views expressed within the Sixth and Eleventh Circuits, the petition adds, and this inconsistency is already fueling forum shopping in Section 10(b) litigation.

The petition also urges the court to take the opportunity to clarify the scope of the duty to disclose under Section 10(b). The Court has stated that Section 10(b) and Rule 10b-5 do not create an affirmative duty to disclose any and all material information, the petition notes. Since 1934, the Court has recognized only two situations giving rise to an affirmative duty to disclose: in the context of insider trading and when necessary to make earlier statements not misleading. The Second Circuit's holding, the petition contends, undermines and conflicts with the Court's decisions cautioning against judicial expansion of Section 10(b) liability. Left undisturbed, the petition concludes, the Second Circuit's holding could expose issuers to massive liability for omitting information that might later be found to be a trend or uncertainty under Item 303.

**Read the docket.** This case, and others pending before the Court, can be referenced in the latest version of the [Supreme Court Docket](#). Cases are listed separately, along with a brief summary of the questions raised and the status of the appeal.

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

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