No. __-____

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., CITY OF RIVIERA BEACH GENERAL EMPLOYEES RETIREMENT SYSTEM, on behalf of itself and all other similarly situated,

Respondents.

On Petition for Writ of Certiorari to the U.S. Court of Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Section 10(b) of the Securities Exchange Act of 1934 prohibits deception in connection with the purchase or sale of securities. To that end, SEC Rule 10b-5 declares it unlawful to make an untrue statement or omit a material fact "necessary" to make an affirmative statement "not misleading." 17 C.F.R. § 240.10b-5(b). A violation of this requirement can give rise to a private claim—a judicially implied private right of action that this Court has construed narrowly.

Item 303 of SEC Regulation S-K calls for additional disclosures under a different standard. Item 303 is an administrative rule that requires a company to disclose known trends or uncertainties that are likely to have a material impact on its financial position, regardless of whether the company had made any statements that would otherwise be misleading.

Against this backdrop, this case presents the following question:

Whether the Second Circuit erred in holding—in conflict with the Third, Ninth, and Eleventh Circuits—that a failure to make a disclosure required under Item 303 can support a private claim under Section 10(b), even in the absence of an otherwise-misleading statement.

PARTIES TO THE PROCEEDING

Petitioners (defendants-appellees below) are Macquarie Infrastructure Corporation; 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, and William H. Webb; and Macquarie Infrastructure Management (USA) Inc.

Barclays Capital Inc., also a defendant-appellee below, is not participating in this petition.

Respondents (plaintiffs-appellants below) are Moab Partners, L.P. and City of Riviera Beach General Employees Retirement System.

CORPORATE DISCLOSURE STATEMENT

While this litigation has been pending, petitioner Macquarie Infrastructure Corporation (MIC) formally changed its corporate name to "Atlantic Aviation Infrastructure Corporation." (This petition uses the former name MIC.) Atlantic Aviation Infrastructure Corporation's direct parent company and 100% stockholder is KKR Apple Bidco, LLC. No publicly held corporation owns any of Atlantic Aviation Infrastructure Corporation's stock.

Petitioners 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, and William H. Webb are natural persons. They were officers and directors of MIC.

Petitioner Macquarie Infrastructure Management (USA) Inc. (MIMUSA) is a wholly owned subsidiary of Macquarie Infrastructure and Real Assets Inc., a privately held corporation established under the laws of

Delaware. MIMUSA is indirectly wholly owned by Macquarie Group Limited, a publicly held corporation established under the laws of Australia and listed on the Australian Securities Exchange. No publicly held corporation holds 10% or more of Macquarie Group Limited's stock.

Barclays Capital Inc., a defendant-appellee below, is an indirect wholly owned subsidiary of Barclays PLC, a publicly traded corporation. No other publicly traded entity owns 10% or more of Barclays Capital Inc.'s stock.

STATEMENT OF RELATED PROCEEDINGS

This case arises from and relates to the following proceedings in the United States Court of Appeals for the Second Circuit and the United States District Court for the Southern District of New York:

- *City of Riviera Beach General Employees Retirement System* v. *Macquarie Infrastructure Corporation, et al.*, No. 18-cv-03608 (VSB) (S.D.N.Y.), judgment entered Sept. 7, 2021.
- *Moab Partners, L.P.* v. *Macquarie Infrastructure Corporation, et al.*, No. 21-2524 (2d Cir.), judgment entered Dec. 20, 2022, petition for rehearing denied on Jan. 27, 2023.

Following the Second Circuit's remand, the defendants renewed their motions to dismiss certain counts on grounds that the district court and Second Circuit did not reach. While those motions are pending, discovery and all other proceedings are stayed under the automatic stay provision of the Private Securities Litigation Reform Act of 1995. Dist. Ct. ECF 133 at 1 (Apr. 4, 2023); *see also* 15 U.S.C. § 77z-1(b)(1).

No other proceedings in state or federal trial or appellate courts directly relate to this case under this Court's Rule 14.1(b)(iii).

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PETITION FOR A WRIT OF CERTIORARI

This petition gives the Court another chance to resolve a persistent conflict of authority under the federal securities laws. The question is whether private parties can sue under Section 10(b) of the Securities Exchange Act and SEC Rule 10b-5 based on a company's alleged failure to comply with disclosure requirements in Item 303 of the SEC's Regulation S-K. For several years, this question divided the circuits with the largest securities dockets, with the Second Circuit taking one view and the Third and Ninth taking the opposite. In 2017, this Court recognized the conflict and granted review, but the case settled before argument. *See Leidos, Inc.* v. *Ind. Pub. Ret. Sys.*, No. 16-581. Since then, the conflict has only become more entrenched. The Court should grant review once again.

Section 10(b) prohibits manipulation and deception in the purchase and sale of securities. *See* 15 U.S.C. § 78j(b). As this Court has observed, this provision and its promulgating rule, Rule 10b-5, "do not create an affirmative duty to disclose any and all material information." *Matrixx Initiatives, Inc.* v. *Siracusano*, 563 U.S. 27, 44 (2011). Instead, other than in the context of insider trading, they require disclosure only to the extent "necessary" to make an affirmative statement "not misleading." 17 C.F.R. § 240.10b-5(b). A company can limit its speech without violating Rule 10b-5; it is not required to tell investors everything they might want to know. But it cannot tell misleading half-truths. A violation of Rule 10b-5 gives rise to a private claim under Section 10(b)—a judicially implied private right of action that this Court has been loath to expand. *See*, *e.g.*, *Janus Cap. Grp., Inc.* v. *First Deriv. Traders*, 564 U.S. 135, 142 (2011).

The question here is whether a Section 10(b) claim can also rest on a failure to provide a disclosure required under Item 303 of SEC Regulation S-K, even without an affirmative statement that is rendered misleading by omission. Item 303 requires a company to disclose "known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact" on its financial performance. 17 C.F.R. § 229.303(b)(2)(ii). By its nature, Item 303 does not create a hard-and-fast rule about what facts must be disclosed; it depends on management's judgment about what is reasonably likely to occur in the future. Under some circumstances, disclosure is mandatory; under others, optional. A question about such judgments can give rise to an SEC inquiry and potentially an enforcement action if the SEC finds it warranted.

What such a question should ***not*** do, however, is open the floodgates to potentially crippling private class action liability. That is precisely why the Ninth Circuit declined to recognize alleged violations of Item 303 as a basis for a claim under Section 10(b). Persuaded by a Third Circuit decision written by then-Judge Alito, the Ninth Circuit held that "Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5." *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1054, 1056 (9th Cir. 2014); *see also Oran* v. *Stafford*, 226 F.3d 275, 286 n.6 (3d Cir. 2000) (Alito, J.). Because Item 303 requires disclosures that Rule 10b-5 does not, the Ninth Circuit has held that a duty to disclose must "be separately shown" to support private Section 10(b) liability. *NVIDIA*, 768 F.3d at 1056.

Not so in the Second Circuit. Acknowledging that its decision places it "at odds with the Ninth Circuit," the

Second Circuit has long held that an Item 303 violation ***can*** be a basis for private liability under Section 10(b), even without an otherwise misleading statement. *See Stratte-McClure* v. *Morgan Stanley*, 776 F.3d 94, 103 (2d Cir. 2015). The Second Circuit applied this rule in *Indiana Public Retirement System* v. *SAIC, Inc.*, and this Court granted certiorari in 2017 to resolve the conflict. 818 F.3d 85, 94 (2d Cir. 2015), *cert. granted sub nom. Leidos Inc.* v. *Ind. Pub. Ret. Sys.*, 137 S. Ct. 1395, 1396 (2017). But the case settled before argument.

In the last five years, the conflict has only deepened. Adopting the logic of the Third and Ninth Circuits, the Eleventh Circuit has recognized that because of the differences in the standards underlying Item 303 and Section 10(b), "a violation of the former does not ipso facto indicate a violation of the latter." *Carvelli* v. *Ocwen Fin. Corp.*, 934 F.3d 1307, 1331 (11th Cir. 2019). And the Fifth Circuit has acknowledged the circuit split, declaring that it "ha[s] never held that Item 303 creates a duty to disclose under the Securities Exchange Act." *Mun. Emps.' Ret. Sys. of Mich.* v. *Pier 1 Imports, Inc.*, 935 F.3d 424, 436 (5th Cir. 2019).

Meanwhile, the Second Circuit has doubled down on its position, citing its prior decisions repeatedly. And here, it applied those decisions under circumstances that aptly illustrate the practical difficulty of allowing such a dramatic expansion of private liability. Whether Item 303 has been violated is an often-elusive question that depends on the blurry line the SEC has drawn between "required" and "optional" disclosures. While the defendants here contend that the disclosure of possible future events was (at most) optional, the plaintiff alleges that it was required. In the Second Circuit, such an allegation is apparently enough for a

private lawsuit to survive a motion to dismiss and proceed to class certification. And because the Item 303 analysis itself has a subjective component, the Second Circuit was willing to leapfrog over the scienter requirement altogether. These difficulties illustrate the kinds of mischief that can arise when vague administrative rules become a basis for class action lawsuits claiming potentially sweeping private liability.

The Court should again grant certiorari to resolve the conflict. The outsized role of the Second Circuit in securities litigation makes its views particularly influential—and its error particularly problematic. Even now, the amped-up risk for executives is leading them to err on the side of overdisclosure. This creates unnecessary costs and makes already-lengthy corporate filings even less useful to the market. And in any event, the potential consequences of nondisclosure should be consistent across the nation. The liability of a corporation and its executives should not depend on which coast the plaintiff chooses for its lawsuit. This Court should grant review.

OPINIONS BELOW

The Second Circuit's decision (Pet. 1a–13a) is not reported but is available at 2022 WL 17815767. The district court's dismissal (Pet. 14a–48a) is not reported but is available at 2021 WL 4084572.

JURISDICTION

On December 20, 2022, the Second Circuit vacated the district court's dismissal order and remanded the case for further proceedings. Pet. 1a, 4a. MIC timely filed a petition for rehearing on January 3, 2020, and the Second Circuit denied it on January 27, 2023. Pet. 49a–50a. By order dated April 24, 2023, Justice Sotomayor granted MIC's application to extend the time for this petition to May 30, 2023. No. 22A920.

This Court has jurisdiction under 28 U.S.C. § 1254(1). The Second Circuit had jurisdiction under 28 U.S.C. § 1291, and the district court had jurisdiction under 28 U.S.C. § 1331.

STATUTORY PROVISIONS INVOLVED

This case implicates Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)), Securities and Exchange Commission Rule 10b-5 (17 C.F.R. § 240.10b-5), and Securities and Exchange Commission Regulation S-K, Item 303 (17 C.F.R. § 229.303).[1] These provisions are reproduced at Pet. 51a–61a.

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[1] The provision of Item 303 at issue in this case was amended in 2021 (*see* Pet. 54a–55a & n.1)—but not in a manner that would abrogate the question presented here. The current version of the relevant provision requires issuing companies to "[d]escribe any known trends or uncertainties that *have had or that are reasonably likely to have* a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(b)(2)(ii) (2021) (emphasis added). The version in effect when this suit was filed (and when *Stratte-McClure* was decided and certiorari was granted in *Leidos*) required them to "[d]escribe any known trends or uncertainties that *have had or that the registrant reasonably expects will have* a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(a)(3)(ii) (2018) (emphasis added). The change in language is immaterial. From the beginning, the SEC's interpretive guidance has framed Item 303 in terms of whether the trend or uncertainty was "reasonably likely to have material effects"—the same language the current version reflects. *See* Management's Discussion and Analysis of Financial Condition and Results of Operations, Exchange Act Release No. 26,831 ("Interpretive Release"), 54 Fed. Reg. 22,427, 22,429 (May 24, 1989).

STATEMENT OF THE CASE

A. MIC's business

MIC was a publicly traded company that owned and operated a portfolio of infrastructure-related businesses. One of these was International-Matex Tank Terminals (IMTT), which was among the largest providers of third-party bulk liquid storage services in the United States. IMTT's terminals stored or handled commodity and specialty chemicals, vegetable and tropical oils, and refined petroleum products such as No. 6 oil (a high-sulfur fuel oil sometimes called "black oil"). IMTT has been involved in the storage of No. 6 oil since the 1970s—a fact that MIC has consistently disclosed.

Starting in the 1980s, environmental regulations caused demand for No. 6 oil to decline. But because No. 6 oil is a byproduct of the refining process, it is still being produced and must still be handled and stored. In fact, as demand for No. 6 oil decreased, the demand for IMTT's storage services increased. Pet. 22a.

In 2008, the International Maritime Organization (IMO)—a United Nations agency charged with regulating global shipping—promulgated "IMO 2020," a proposed regulation that would cap the sulfur content of fuel oil used in shipping at 0.5% by the beginning of 2020. Pet. 18a–19a. This raised questions about No. 6 oil, which contains about 3% sulfur. Some observers predicted that demand for No. 6 oil would be eliminated altogether, but others predicted that emerging technologies could mitigate the excess sulfur. Pet. 18a–19a. Still other experts believed that IMO 2020

would be revised before it went into effect—or that its effective date would be delayed. JA486.[2]

In late 2016—after the beginning of the putative class period in this case—the IMO "announced that it concluded its review" of the potential regulation and "formally fixed" the 0.5% sulfur cap to go into effect in 2020. Pet. 19a. This announcement was "widely reported." *Id.* In the meantime, IMTT proceeded with business as usual and remained highly successful. Throughout 2016 and most of 2017, nearly all the IMTT tanks designed to store No. 6 oil had been leased, and IMTT maintained utilization rates exceeding historic levels.

In late 2017 and early 2018, IMTT experienced a sudden and unexpected decline in demand for storage at its facilities, when a larger-than-expected number of IMTT's customers gave notice of their intent not to renew their contracts for storage of No. 6 oil. JA702–03. As MIC later explained to the market, the reasons for nonrenewal "reflected both continuing changes in domestic and global demand for the product, and market conditions for trading customers." JA696.

On February 22, 2018, MIC announced its successful fourth quarter and year-end 2017 financial results, showing an 8% increase in cash flow. JA70–71; Pet. 22a–23a. At the same time, though, MIC announced that it was reducing its 2018 dividend guidance to retain a greater share of its free cash flow to fund its businesses. On this news, MIC's stock price dropped.

The next day, MIC's then-new CEO explained the factors that led to the Board's decision to lower the anticipated dividend. These factors included issues af-

[2] "JA" citations refer to the Second Circuit Joint Appendix.

fecting MIC's access to capital markets, new tax incentives to invest in its own portfolio, and a desire to maintain a more flexible balance sheet, among others. While the sudden and unexpected decline in demand for storage at IMTT was also identified as one of the factors, it was by no means the only reason given. JA702, JA719.

B. This lawsuit

This lawsuit followed, and Moab Partners, L.P.—a sophisticated activist investor—was ultimately appointed lead plaintiff. Moab then filed the operative complaint, asserting securities claims against MIC, several former officers and directors of MIC and IMTT, another company in the Macquarie Group (MIMUSA) that provided management and other services to MIC, and Barclays Capital Inc., which had served as underwriter for a November 2016 secondary offering of MIC stock. JA31–33, JA123. The complaint alleged violations of Section 10(b) and Rule 10b-5, as well as claims under Section 20(a) ("control person" liability, 15 U.S.C § 78t(a)), and Section 20A (insider trading, *id.* § 78t-1). JA117–20. In addition, the complaint alleged violations of Section 11 (misrepresentations in registration statement, 15 U.S.C. § 77k), Section 12(a)(2) (misrepresentations in prospectus, *id.* § 77l), and Section 15 (control person liability, *id.* § 77o) of the Securities Act. JA129–33. Moab sought to represent a class of all purchasers of MIC stock (i) between February 22, 2016, and February 21, 2018, and/or (ii) in or traceable to the November 2016 secondary offering. JA133.

As relevant here, Moab's central allegation is that between February 2016 and February 2018, MIC and its management defrauded investors by failing to predict and disclose that IMO 2020 would have a material

negative impact on MIC's overall financial performance. Moab contends that management should have anticipated and disclosed the regulation's impact years before it went into effect (and, indeed, even before the late-2016 announcement when the IMO confirmed that the regulation would, in fact, go into effect in 2020). Pet. 28a. Specifically, Moab alleges that MIC and/or the individual defendants were required but failed to disclose (a) "[IMTT's] reliance on revenue from the storage of No. 6 oil"; (b) the risk that implementation of IMO 2020 "would severely curtail 'the demand for storage'" of No. 6 oil at IMTT; and (c) the risk that IMTT would "need to undertake significant capital expenditures to repurpose" some of its tanks in response to market conditions. JA23, JA26, JA83, JA102.

C. The district court's dismissal

The defendants moved to dismiss the complaint for failure to state a claim, and the district court granted the motion.

To start, the court rejected Moab's argument that MIC violated a disclosure obligation under Item 303 of SEC Regulation S-K, 17 C.F.R. § 229.303, "which obligates a company to make a disclosure in its SEC filings 'where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial conditions or results of operations.'" Pet. 30a–31a (quoting *SAIC*, 818 F.3d at 94).

The district court reached this conclusion after analyzing two published 2015 Second Circuit decisions that held that "a violation of Item 303 [could be] sufficient to support a Section 10(b) claim." *Id.* (citing *Stratte-McClure*, 776 F.3d at 101–03, and *SAIC*, 818 F.3d at 94–95). Distinguishing *SAIC*, the district court

in this case concluded that the facts Moab pled were insufficient to trigger Item 303's disclosure requirement. Pet. 39a–40a. According to the district court, Moab had failed to plead "an uncertainty that should have been disclosed" and "in what SEC filing or filings Defendants were supposed to disclose it." Pet. 39a. The complaint "d[id] not 'allege that' any 'omitted information was material' under the relevant 'probability/magnitude test' for assessing Item 303 violations." *Id.* (quoting *Stratte-McClure*, 776 F.3d at 103). Nor did Moab allege "when Defendants 'actually kn[ew]' of * * * facts" that would have required disclosure. Pet. 40a (quoting *SAIC*, 818 F.3d at 95).

The district court also found that Moab had failed to allege facts to support a strong inference of scienter, as required by the heightened pleading standard of the Private Securities Litigation Reform Act of 1995 (PSLRA), Pub. L. No. 104-67, 109 Stat. 737. Pet. 42a–47a; *see also* Pet. 26a (quoting 15 U.S.C. § 78u-4(b)). The court explained that even if "Defendants were negligent concerning the risks IMTT faced in its exposure to a potential downturn in the demand to store No. 6 fuel oil," "that is not legally sufficient to demonstrate scienter" with respect to any inaccuracy in its disclosures. Pet. 47a.

Because Moab's other Exchange Act and Securities Act claims required either a primary violation or a material misrepresentation or omission and the court had found none, the court dismissed those claims as well. Pet. 47a–48a.

D. The Second Circuit's decision

The Second Circuit disagreed, holding that Moab had alleged actionable omissions for purposes of Section 10(b) and Sections 11 and 12(a)(2). Pet. 5a. The

panel "agree[d] with the district court that the majority of Defendants' alleged misstatements are not actionable." Pet. 7a. But it concluded that Moab "ha[d] adequately alleged a 'known trend[] or uncertaint[y]' that gave rise to a duty to disclose under Item 303." *Id.* (quoting *Stratte-McClure*, 776 F.3d at 101 (in turn quoting Item 303)).

In the panel's view, the complaint adequately alleged that "even if Defendants could not determine with certainty that IMO 2020 would be implemented," the regulation's potentially "significant restriction of No. 6 fuel oil use" in the future "was known to Defendants and reasonably likely to have material effects on MIC's financial condition or results of operation" if and when it went into effect. Pet. 9a. Following circuit precedent, the panel reasoned that because this information was not "so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of [its] importance," the complaint sufficiently alleged it was material and had to be disclosed under Item 303. Pet. 10a (quoting *Litwin* v. *Blackstone Grp., L.P.*, 634 F.3d 706, 717 (2d Cir. 2011)).

Further, not only was this purported Item 303 violation sufficient to establish an actionable omission for purposes of all of Moab's claims (Pet. 8a–10a), but the panel also found it sufficient to establish scienter under Section 10(b). Pet. 10a–11a. According to the panel, the PSLRA's heightened standard was satisfied because Defendants were allegedly in the "position of knowing" that "it was likely" that IMO 2020 would reduce revenue, and yet they "did not make corresponding disclosures." Pet. 11a–12a.

Because the other claims were predicated on a finding of liability under Section 10(b) of the Exchange Act and Sections 11 and 12(a)(2) of the Securities Act, the

district court vacated the judgment of dismissal as to all claims and remanded the case to the district court.[3]

REASONS FOR GRANTING THE PETITION

This case presents a square circuit split on an important securities law issue: whether an alleged violation of the duty to disclose under Item 303 can support a private cause of action under Section 10(b) and Rule 10b-5. This Court granted review to resolve this circuit split in 2017, but the case settled before argument.

In the last five years, the conflict has only become more entrenched. As discussed below, the Eleventh Circuit has now joined the Third and Ninth in holding that a failure to disclose under Item 303 is not sufficient on its own to support a private cause of action. The Fifth Circuit has expressed a similar view in dicta. And meanwhile, the Second Circuit has not reconsidered its contrary position; it has doubled down, citing its prior decisions repeatedly and applying them again in this case.

The Second Circuit's broad view of Section 10(b) liability has the effect of further expanding the private right of action for securities fraud—precisely what several members of this Court have cautioned against. Expanding liability by judicial fiat contravenes Congress's efforts to limit Section 10(b) liability in the PSLRA and rein in the costs to companies of defending against potentially company-crippling securities fraud suits. And moreover, as this case illustrates, Item 303

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[3] The ongoing proceedings are not a barrier to review. Many of this Court's securities cases have involved court of appeals decisions that left additional proceedings moving forward in the district court. *See, e.g.*, *Matrixx Initiatives*, 563 U.S. at 27; *Janus*, 564 U.S. at 140–41; *Dura Pharms., Inc.* v. *Broudo*, 544 U.S. 336, 340 (2005).

is particularly unsuitable as a basis for expanding liability, as the fine line the SEC has drawn between required disclosures and those that are merely optional incentivizes issuers to err on the side of overdisclosure of irrelevant or distracting information. This outcome is the worst of both worlds: expensive to issuers and unhelpful to potential investors.

The conflict in this case involves the three busiest circuits for securities litigation: the Second and Ninth, and (to a lesser extent) the Third.[4] It also opens the door to forum shopping—a trend that finds support in the data. By the numbers, the Second Circuit is the preferred filing destination for Item 303 plaintiffs—not just in terms of the sheer number of cases, but in the percentage of securities cases brought using an Item 303 theory. *See* Pet. 62a–75a. Notably, even as the Ninth Circuit has become a more popular jurisdiction for securities cases generally, the number of Item 303 cases filed there has seen no corresponding increase. *Compare* McIntosh, *supra* n.4, *with* Pet. 62a.

The Court should take this opportunity to resolve the conflict and clarify that Section 10(b) liability arises only where a company makes a statement that is untrue or misleading without further disclosure—not when the company allegedly fails to make all disclosures required by SEC rules.

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[4] *See* Janeen McIntosh et al., NERA Economic Consulting, *Recent Trends in Securities Class Action Litigation: 2022 Full-Year Review* 5 (Jan. 24, 2023), https://perma.cc/YCD8-WH2J.

I. The Second Circuit's expansive view of Section 10(b) liability puts it in direct conflict with its sister circuits and this Court.

A. At least three circuits have now held that a Section 10(b) claim cannot be based solely on an alleged violation of Item 303.

1. The Third Circuit was the first court of appeals to address the intersection between Item 303 and Section 10(b). *See Oran* v. *Stafford*, 226 F.3d 275 (3d Cir. 2000). In *Oran*, the plaintiffs' theory of 10(b) and 10b-5 liability was that the company was aware of a "trend[] or uncertaint[y]" that could "have a material * * * unfavorable impact"—a possible link between its weight-loss drugs and heart-valve damage—and was therefore required to disclose it under Item 303. *Id.* at 287 (quoting Item 303).

Writing for the panel, then-Judge Alito rejected the argument that the company's alleged violation of Item 303 was actionable under Section 10(b). *See id.* at 288. There were two possible paths to liability, but neither was viable. *Id.* at 287. First, an Item 303 violation could be actionable if Item 303 "create[d] an independent private right of action," but neither "the language of the regulation nor the SEC's interpretative releases construing it" supported one. *Id.* Second, there could be liability under Section 10(b) if Item 303 "impose[d] an affirmative duty of disclosure * * * that, if violated, would constitute a material omission under Rule 10b-5." *Id.* But this path was not viable either, as "the materiality standards for Rule 10b-5 and [Item] 303 differ significantly." *Id.* at 288.

The Rule 10b-5 standard was set in *Basic Inc.* v. *Levinson*, which held that the statement or omission in question must be "misleading as to a material fact."

485 U.S. at 238. When the statement involves "contingent or speculative" future events, materiality "depend[s] * * * upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." *Id.* (quotation omitted).

Item 303, by contrast, requires the issuer who knows of a future trend, event, or uncertainty to "make two assessments": (1) whether it is "likely to come to fruition," and (2) if such a determination is not possible, an objective evaluation of "the consequences * * * on the assumption that it will come to fruition." *Oran*, 226 F.3d at 287 (quoting Interpretive Release, 54 Fed. Reg. at 22,430). Disclosure is required "unless management determines that a material effect on the [issuer]'s financial condition or results of operations is not reasonably likely to occur." *Id.*

The Third Circuit recognized that these disclosure obligations "extend considerably beyond those required by Rule 10b-5" under *Basic*'s materiality test. *Id.* at 288 (quoting Interpretive Release, 54 Fed. Reg. at 22,430 n.27). "Because the materiality standards for Rule 10b-5 and [Item]303 differ significantly," the court held that a violation of Item 303's disclosure requirement "does not automatically give rise to a material omission under Rule 10b-5." *Id.* A "duty to disclose" under Rule 10b-5 "must be separately shown." *Id.* (quotation omitted).

2. The Ninth Circuit, "persuaded by" *Oran*, has also concluded that "Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5." *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046, 1054, 1056 (9th Cir. 2014). Like the Third Circuit, the Ninth Circuit in *NVIDIA* examined the standard set in *Basic*—which makes clear that Section 10(b) and Rule 10b-5 require disclosure only when disclosure is necessary to

ensure that "statements made, in the light of the circumstances under which they were made, [are] not misleading." *NVIDIA*, 768 F.3d at 1054 (quoting *Matrixx Initiatives*, 563 U.S. at 44). On that basis, the Ninth Circuit reached the same conclusion: because Item 303 requires disclosures that Section 10(b) and Rule 10b-5 do not, a duty to disclose under Section 10(b) must "be separately shown" to give rise to private liability. *Id.* at 1056.

The Ninth Circuit specifically rebuffed the plaintiffs' attempt to analogize to two earlier Second Circuit Securities Act cases that recognized a duty to disclose under Item 303: *Panther Partners Inc.* v. *Ikanos Communications, Inc.*, 681 F.3d 114 (2d Cir. 2012), and *Litwin* v. *Blackstone Group, L.P.*, 634 F.3d 706 (2d Cir. 2011). *See NVIDIA*, 768 F.3d at 1055–56. Importantly, both cases focused on Section 11 of the Securities Act, which "imposes strict liability" for a registration statement that "contain[s] an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein ***or*** necessary to make the statements therein not misleading." *See Panther Partners*, 681 F.3d at 120 (quoting 15 U.S.C. § 77k(a)) (emphasis added); *accord Litwin*, 634 F.3d at 715–16. The Ninth Circuit in *NVIDIA* distinguished these cases, explaining that while liability under Section 11 "arises from 'an omission in contravention of an affirmative legal disclosure obligation,'" there is "no such requirement under Section 10(b) or Rule 10b-5." *NVIDIA*, 768 F.3d at 1055–56 (quoting *Panther Partners*, 681 F.3d at 120). For purposes of Section 10(b), "material information need not be disclosed unless omission of that information would cause other information that is disclosed to be misleading." *Id.* at 1056 (citing *Matrixx Initiatives*, 563 U.S. at 43).

3. The Eleventh Circuit has now weighed in as well. Writing for a panel that included Judges Pryor and Branch, Judge Newsom recognized that "[t]he disclosure obligations imposed by Item 303 and Rule 10b-5 are materially * * * different." *Carvelli*, 934 F.3d at 1330–31. On that basis, the court agreed with the Third and Ninth Circuits that "Item 303 imposes a more sweeping disclosure obligation than Rule 10b-5, such that a violation of the former does not *ipso facto* indicate a violation of the latter." *Id.* at 1331.

4. Two other circuits have expressed a similar view, albeit less squarely. Even before *Oran*, the Sixth Circuit, in rejecting a private right of action under Item 303, briefly considered the argument that "defendants' disclosure duty under the Rule 10b-5 claim may stem from Item 303"—only to summarily reject it as unpersuasive. *In re Sofamor Danek Grp., Inc.*, 123 F.3d 394, 403 (6th Cir. 1997). And more recently, the Fifth Circuit, recognizing the circuit split on this issue, stated that it "ha[s] never held that Item 303 creates a duty to disclose under the Securities Exchange Act." *See Mun. Emps.' Ret. Sys. of Mich.* v. *Pier 1 Imports, Inc.*, 935 F.3d 424, 436 (5th Cir. 2019).

B. The Second Circuit persists in the contrary view: that a violation of Item 303 is actionable as an omission under Section 10(b).

The Second Circuit has gone the other way—and it has doubled down on its view in the years since this Court granted review in *Leidos*.

1. In *Stratte-McClure* v. *Morgan Stanley*, decided shortly after *NVIDIA*, the Second Circuit held "that a failure to make a required Item 303 disclosure in a [mandatory SEC] filing is indeed an omission that can serve as the basis for a Section 10(b) securities fraud

claim." 776 F.3d at 100. The court acknowledged that its decision was "at odds with the Ninth Circuit's recent opinion" in *NVIDIA*. *Id.* at 103. It departed from the Ninth Circuit for two reasons.

First, the Second Circuit thought—erroneously—that the *NVIDIA* court had misread *Oran*. *Id.* In the Second Circuit's view, *Oran* "actually suggested, without deciding, that in certain instances a violation of Item 303 ***could*** give rise to a material 10b-5 omission." *Id.* But then-Judge Alito could not have been clearer about what the Third Circuit was doing: "reject[ing] plaintiffs' claim that [Item 303] imposed an affirmative duty of disclosure * * * that could give rise to a claim under Rule 10b-5." *Oran*, 226 F.3d at 286 n.6.

Second, unlike the Ninth Circuit, the Second Circuit found its earlier decisions in *Panther Partners* and *Litwin* to be both relevant and persuasive, even though they did not involve the Exchange Act. *See Stratte-McClure*, 776 F.3d at 104. In those cases, the court had held that Item 303 omissions are actionable under Sections 11 and 12(a)(2) of the Securities Act. *Id.* Following *Panther Partners* and *Litwin* rather than *NVIDIA*, the Second Circuit concluded that an alleged violation of Item 303's "duty to disclose" was sufficient to support a claim under the Exchange Act as well. *Id.*

This conclusion ignored the difference in the text of Section 10(b) of the Exchange Act and Section 11 of the Securities Act that the Ninth Circuit had found to be determinative. Whereas Section 11 is often read to impose liability for "an omission in contravention of an affirmative legal disclosure obligation" (*Panther Partners*, 681 F.3d at 120), the text of Rule 10b-5 makes

clear that "no such requirement" exists. *NVIDIA*, 768 F.3d at 1056.[5]

Ultimately, the court in *Stratte-McClure* discounted this textual difference between the Securities Act and the Exchange Act by pointing out that Section 12(a)(2) of the Securities Act "is textually identical to * * * Rule 10b-5." 776 F.3d at 104. But the fact remains that neither *Panther Partners* nor *Litwin*, which the court ultimately relied on for this point, acknowledged the difference between Sections 11 and 12(a)(2), let alone wrangled with its implications. *See Panther Partners*, 681 F.3d at 120 (saying only that "Section 12(a)(2) imposes similar circumstances [to Section 11] for misstatements and omissions in a prospectus"); *Litwin*, 634 F.3d at 715 ("Section 12(a)(2) imposes liability under similar circumstances" to Section 11 "by means of a prospectus."). Treating these materially different sections interchangeably was a fundamental error that infected the court's entire analysis.

2. The Second Circuit repeated and compounded this error when it applied the rule of *Stratte-McClure* in *SAIC*—the case in which this Court would later grant certiorari under the name *Leidos*.

There, the plaintiffs alleged securities fraud under Section 10(b) on the basis of SAIC's failure to disclose in its filings an ongoing criminal investigation of SAIC employees who participated in an alleged kickback scheme in the course of their work on a high-profile company project. *SAIC*, 818 F.3d at 89–91. According

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[5] The same is true of the text of Section 12(a)(2), which is identical to that of Rule 10b-5. For this reason, a determination that a failure to make a disclosure required under Item 303 cannot support a private claim under Section 10(b) should apply with equal force to Section 12(a)(2).

to the plaintiffs, not disclosing SAIC's potential liability as a result of the scandal amounted to a "failure to disclose a known trend or uncertainty reasonably expected to have a material impact on its financial condition, in violation of Item 303." *Id.* at 88. Citing *Stratte-McClure*, *Panther Partners*, and *Litwin*, the court took for granted that Item 303 could serve as a basis for Section 10(b) liability. *See SAIC*, 818 F.3d at 94. It rejected SAIC's arguments that the plaintiffs had failed to plead an Item 303 violation and allowed the claim to proceed. *See id.* at 94–95.

SAIC then sought a writ of certiorari from this Court on the question "[w]hether the Second Circuit erred in holding—in direct conflict with the decisions of the Third and Ninth Circuits—that Item 303 * * * creates a duty to disclose that is actionable under Section 10(b)." Petition for Writ of Certiorari at i, *Leidos* (U.S. Oct. 31, 2016). Although the Court granted the writ (*Leidos*, 137 S. Ct. at 1396), the case settled and was dismissed before the merits question could be resolved.

3. Since *Leidos* was dismissed, the Second Circuit has repeatedly doubled down on its position, reiterating in both word and deed its view that a violation of Item 303 can be the basis for a securities claim. *See, e.g.*, *Bristol Cnty. Ret. Sys.* v. *Adient PLC*, 2022 WL 2824260, at *2 (2d Cir.) (citing *Stratte-McClure*); *Loc. #817 IBT Pension Fund* v. *XPO Logistics, Inc.*, 2022 WL 2358414, at *4 (2d Cir.) (same); *Asay* v. *Pinduoduo Inc.*, 2021 WL 3871269, at *4 n.5 (2d Cir.) (same); *In re Gen. Elec. Sec. Litig.*, 844 F. App'x 385, 387 (2d Cir. 2021) (same); *Steamfitters' Indus. Pension Fund* v. *Endo Int'l PLC*, 771 F. App'x 494, 498 (2d Cir. 2019) (same); *Christine Asia Co.* v. *Ma*, 718 F. App'x 20, 23 (2d Cir. 2017) (same).

At the same time, the nature of these cases prevented the issue from coming before this Court for review. In all but one of the cases listed above, for example, the dismissals of the claims based on Item 303 were affirmed on other grounds: either the facts did not establish an Item 303 violation in the first place, or the plaintiff could not plead scienter. *See Bristol Cnty. Ret. Sys.*, 2022 WL 2824260, at *2 (no material omissions); *Loc. #817 IBT Pension Fund*, 2022 WL 2358414, at *4 (failure to plead scienter); *Asay*, 2021 WL 3871269, at *4 n.5 (omission not material); *Gen. Elec.*, 844 F. App'x at 387 (2d Cir. 2021) (no scienter); *Steamfitters' Indus. Pension Fund*, 771 F. App'x at 498 (business strategy decision at issue not an Item 303 violation).

As the losing party, the plaintiff in these cases would have had no incentive to seek review of the Second Circuit's approach to Item 303, as that approach only makes it easier for plaintiffs to state a claim. In the current case, by contrast, the Second Circuit applied the *Stratte-McClure* and *SAIC/Leidos* principle to rule against the defendant—creating a rare opportunity to resolve the stubborn split of authority.[6]

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[6] The split has also generated confusion among the district courts in circuits that have not yet chosen a side. *Compare, e.g.*, *Allison* v. *Oak Street Health, Inc.*, 2023 WL 1928119, at *8 (N.D. Ill.) (finding "the Second Circuit's reasoning in *Stratte-McClure* compelling"), *with In re SCANA Corp. Sec. Litig.*, 2019 WL 1427443, at *11 (D.S.C.) (following Ninth Circuit rule). Other courts have avoided the question entirely. *See, e.g.*, *Crutchfield* v. *Match Grp., Inc.*, 529 F. Supp. 3d 570, 592 (N.D. Tex. 2021); *Izadjoo* v. *Helix Energy Sols. Grp., Inc.*, 237 F. Supp. 3d 492, 513 n.6 (S.D. Tex. 2017).

II. The Second Circuit's approach expands liability under Section 10(b) in a way that conflicts with this Court's cases.

The Second Circuit's view of the private right of action under Section 10(b)—already broad after the court split from the other circuits in *Stratte-McClure*, and broadened even further in this case—has gone well beyond what this Court's precedents permit. This Court has repeatedly declined to expand the implied private right of action under Section 10(b), instead confining it to what it was originally designed to punish and deter: deception. The conflict with this Court's Section 10(b) cases provides an additional reason to grant certiorari.

A. Basing 10b-5 liability on a violation of a different SEC disclosure obligation enlarges the private right of action in a way this Court's cases do not permit.

The Second Circuit's approach to Item 303 has expanded the scope of the private right of action under Section 10(b). This expansion is not supported by either congressional intent or this Court's precedent. Indeed, both counsel ***against*** expansion.

1. This Court has repeatedly made clear that "the § 10(b) private right should not be extended beyond its present boundaries." *Stoneridge Inv. Partners, LLC* v. *Sci.-Atl., Inc.*, 552 U.S. 148, 166 (2008) ("Concerns with the judicial creation of a private cause of action caution against its expansion. The decision to extend the cause of action is for Congress, not for us."); *see also Cent. Bank of Denver, N.A.* v. *First Interstate Bank, N.A.*, 511 U.S. 164, 177–78 (1994) (refusing to recognize private 10(b) right of action for aiding and abetting because "[w]e cannot amend the statute to create liability for acts that are not themselves manipulative

or deceptive within the meaning of the statute"); *Santa Fe Indus.* v. *Green*, 430 U.S. 462, 464 (1977) (declining to "judicial[ly] exten[d]10(b) and Rule 10b-5" to encompass breaches of fiduciary duty unrelated to misrepresentation or nondisclosure). It has declined to extend the private right of action under other securities laws for similar reasons. *See, e.g.*, *Va. Bankshares* v. *Sandberg*, 501 U.S. 1083, 1102 (1991) (declining to extend right of action under Exchange Act § 14(a) to certain minority shareholders). These cases are consistent with the fundamental rule that "recognition of any private right of action for violating a federal statute must ultimately rest on congressional intent to provide a private remedy." *Id.*

2. Congress intended Section 10(b) to address a specific problem—deception—and expanding the right of action beyond that context frustrates its purpose.

On its face, Section 10(b) is not about the completeness of disclosures; it is about prohibiting any "manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b). That is why Rule 10b-5 makes omissions unlawful only when the omitted information is a "material fact necessary in order to make the statements made * * * not misleading." 17 C.F.R. § 240.10b-5. "On multiple occasions, this Court has reaffirmed the fundamental principle that "[s]ilence, absent a duty to disclose, is not ***misleading*** under Rule 10b-5." *Basic*, 485 U.S. at 239 n.17 (emphasis added). As a result, companies can "control what they have to disclose under these provisions by controlling what they say to the market." *Matrixx Initiatives*, 563 U.S. at 45.

"[N]o court * * * has found a private right of action under Item 303, and the rule itself doesn't seem to contemplate one." *Carvelli*, 934 F.3d at 1330; *accord Oran*, 226 F.3d at 287 (collecting cases). By nonetheless recognizing a private cause of action for an

Item 303 violation through the vehicle of a Section 10(b) claim, the Second Circuit permits plaintiffs to plead around the rule's text—and to evade the limits that this Court has so clearly placed on private claims under Section 10(b).

B. Item 303 is uniquely unsuited for an implied private right of action.

The Second Circuit's expansion of the private right of action to include Item 303 violations is not only unwarranted: it is uniquely problematic.

Again, this Court has repeatedly recognized the limits on what Section 10(b) requires issuers to disclose. It "do[es] not create an affirmative duty to disclose any and all material information," and even when information "might [be reasonably] consider[ed] material, companies can control what they have to disclose * * * by controlling what they say to the market." *Matrixx Initiatives*, 563 U.S. at 44–45 (citing 17 C.F.R. § 240.10b-5(b) and *Basic*, 485 U.S. at 239 n.17).

Under Item 303, however, an issuer's disclosure obligations are "intentionally flexible and general." Interpretive Release, 54 Fed. Reg. at 22,436. For example, the SEC requires issuers to disclose "currently known" trends and uncertainties that are reasonably likely to have material effects, but makes it "optional" for issuers to disclose "forward-looking" information that "involves anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty." *Id.* at 22,429. Both types of disclosures, whether required or optional, ultimately consist of "predictions and matters of opinion"—the type of "soft information" that, unlike "hard information," is not "objectively verifiable." *Sofamor Danek*, 123 F.3d at 401 (quotation omitted). Nor is the

SEC's guidance as to what must be disclosed "particularly clear." Denise Voight Crawford & Dean Galaro, *A Rule 10b-5 Private Right of Action for MD&A Violations?*, 43 Sec. Reg. L.J. 1 (2015).

If Item 303 is allowed to serve as a basis for Section 10(b) liability, its nebulous references to "trends" and "uncertainties"—and its requirement in some (but not all) circumstances that companies predict the future impact of those "trends" and "uncertainties"—open the door for plaintiffs to plead an Exchange Act claim on a theory of "fraud by hindsight." *See Denny* v. *Barber*, 576 F.2d 465, 470 (2d Cir. 1978) (coining phrase in rejecting lack of "clairvoyance" as a basis for 10(b) liability). But such "general allegations that defendants knew earlier what later turned out badly" have been rejected as a basis for liability under Section 10(b), as they are "not sufficient" to plead the state of mind required by the PSLRA: scienter. *Ezra Charitable Tr.* v. *Tyco Int'l, Ltd.*, 466 F.3d 1, 6 (1st Cir. 2006) (quotation omitted); *see also Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 193 n.12 (1976) ("[T]he term 'scienter' refers to a mental state embracing intent to deceive, manipulate, or defraud."). In this respect, too, the Second Circuit's view stands in tension with this Court's prior decisions and leads to troubling results.

C. As this case illustrates, the Second Circuit's approach to Item 303 claims conflates optional and required disclosures and collapses the scienter analysis.

This case illustrates how far the Second Circuit has departed from this Court's limits on the private right of action under Section 10(b). Even as *Stratte-McClure* recognized Item 303 as a basis for liability, it also acknowledged that "Item 303's disclosure obligations 'extend considerably beyond those required by Rule

10b-5.'" 776 F.3d at 103 (quoting *Oran*, 226 F.3d at 288). Apparently concerned about this issue, the court in *Stratte-McClure* limited Section 10(b)/Item 303 claims in two ways: (1) remaining mindful of the difference the SEC guidance interpreting Item 303 drew between required and optional disclosures, and (2) making clear that, under the PSLRA, scienter remained a separate and independent element of a Section 10(b) claim.

Here, however, the decision below effectively eliminated these limitations, demonstrating the inherent dangers of expanding the private right of action.

1. In *Stratte-McClure*, the Second Circuit took note of the SEC's distinction between "***required*** disclosures about 'currently known trends * * * that are reasonably expected to have material effects' and ***optional*** "'forward-looking disclosure[s]' that involve[] anticipating a future trend * * * or anticipating a less predictable impact of a known event, trend or uncertainty." 776 F.3d at 105 n.6 (emphases added) (quoting Interpretive Release). The court clarified that only the "failure to make a required Item 303 disclosure" "can serve as the basis for a * * * securities fraud claim." *Id.* at 100. If a disclosure is optional—that is, if it "involves anticipating a future trend * * * or anticipating a less predictable impact of a known event, trend or uncertainty"—Item 303 does not impose an "affirmative duty to disclose," and silence is not actionable under Section 10(b). *Id.* at 105 n.6 (quoting Interpretative Release).

But the line between when an issuer "reasonably expects" a known trend, event, or uncertainty to "have a material * * * unfavorable impact" on future results and when the issuer is "anticipating a less predictable impact of a known event, trend or uncertainty" (*id.* at 102, 105 n.6 (quoting Interpretative Release)) is a

"fine" one. *See* Voight Crawford & Galaro, *supra*. The facts of this case illustrate the difficulty of distinguishing between an actionable "expectation" and a mere "anticipation." For example, global demand for No. 6 oil had been declining even before IMO 2020 was announced in 2008, and yet demand for storage of No. 6 oil at IMTT's facilities increased over that same period. *See* JA431, JA537, JA542. And while some experts predicted that the entire supply chain for No. 6 oil would be impacted by IMO 2020, others—including MIC—saw potential opportunities to use scrubbers to make No. 6 oil compliant with the rule, or to use No. 6 oil for non-ship-fuel purposes that were not covered by IMO 2020. JA67, JA99. At oral argument, the panel appeared to struggle with whether disclosures related to the potential effects of IMO 2020 on the market for No. 6 oil were required or optional. *See* Oral Argument at 18:30–21:15 (2d Cir. No. 21-2524), https://perma.cc/G88P-MNXY.

Ultimately, the panel apparently found Moab's allegations that Item 303 required such disclosures sufficient to survive a motion to dismiss. Still, the difficulty of distinguishing between impacts that are "reasonably expect[ed]" and those that are "less predictable" makes it easy for clever plaintiffs to recharacterize what should properly be considered an optional disclosure as a required one—expanding the bounds of Section 10(b) liability for Item 303 violations even further.

2. The decision below also shows the ineffectiveness of the other limiting principle *Stratte-McClure* identified: the distinction between an Item 303 violation and the scienter requirement.

In another attempt to cabin the circuit split it knew it was creating, the Second Circuit in *Stratte-McClure* emphasized that "[t]he failure to make a required disclosure under Item 303 * * * is not by itself sufficient

to state a claim for securities fraud under Section 10(b)." 776 F.3d at 102. "[A]s with any Section 10(b) claim," a plaintiff alleging an Item 303 violation as a basis for liability "must also sufficiently plead scienter." *Id.* at 103, 106; *see Tellabs, Inc.* v. *Makor Issues & Rts., Ltd.*, 551 U.S. 308, 313–14, 323–24 (2007). Because scienter requires a showing of "conscious recklessness" rather than "a heightened form of negligence," it "should not be found where defendants merely should have anticipated future events and made certain disclosures earlier than they actually did." *Stratte-McClure*, 776 F.3d at 106–07 (quotations omitted).

And yet the panel below concluded that Moab had adequately pled scienter here based simply on the allegation that MIC's management was in the "position of knowing that * * * it was likely that revenue contributions would be down from IMTT" due to IMO 2020 but "did not make corresponding disclosures." Pet. 11a–12a. In effect, the panel concluded that an alleged failure to make a required Item 303 disclosure was sufficient in itself to establish scienter. And in so holding, the court eviscerated one of "the control measures Congress included in the PSLRA" to guard against "abusive litigation": the requirement that "plaintiffs must 'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind,'" which "unequivocally raise[d] the bar for pleading scienter." *Tellabs*, 551 U.S. at 313–14, 321 (quoting 15 U.S.C. § 78u-4(b)(2)).

The decision below thus shows the ineffectiveness of the two limitations that the Second Circuit imposed on Section 10(b) liability for Item 303 violations: the difference between required and optional disclosures, and this Court's heightened requirement for pleading

scienter as opposed to effectively imposing strict liability. Without these limitations, the scope of the implied private right of action under Section 10(b) will be expanded even further. This case thus puts in sharp relief the dangers of expanding the Section 10(b) private right of action so far beyond what Congress and this Court's precedents contemplate.

III. Recognizing Section 10(b) liability claims based on Item 303 violations will incentivize overdisclosure and litigation.

Expanding Section 10(b) liability to include omissions under Item 303 will create dangers that neither Congress, the SEC, nor this Court intended. The Exchange Act's purpose was to "implement[] a philosophy of full disclosure" (*Santa Fe Indus.*, 430 U.S. at 477–78), and the SEC designed Item 303 to make issuers' MD&A[7] disclosures "more meaningful" (Interpretive Release, 54 Fed. Reg. at 22,427). But a sweeping private liability regime will have the opposite effect. Such a rule would require an issuer hoping to avoid lawsuits to predict what information could, with the benefit of hindsight, later be deemed under Item 303 to have been a "trend" or "uncertainty" that the company should have predicted would have a material impact on its financial performance. This lack of clarity incentivizes overdisclosure to the detriment of issuers and investors alike.

1. By endorsing an actionable duty to disclose under Item 303, the Second Circuit's broad view of Sec-

[7] MD&A is a commonly used acronym for "Management Discussion and Analysis," a required section of a public company's annual and quarterly reports in which the company's executives discuss its financial performance.

tion 10(b) liability incentivizes companies to try to insulate themselves from liability by disclosing too much information. Disclosure requirements are already "agonizing to corporate managers," and the prospect of courts "second-guess[ing] disclosure decisions"—especially when the requirements are "uncertain"—will not help matters. *See* Ted J. Fiflis, *Soft Information: The SEC's Former Exogenous Zone*, 26 UCLA L. Rev. 95, 95–96 (1978).

To avoid potential liability, issuers are likely to make defensive, overinclusive disclosures regarding every conceivable future event, trend, or uncertainty. Indeed, after *Stratte-McClure* was decided and around the time this Court granted certiorari in *Leidos*, many law firms publicly warned their issuer clients en masse to exercise a new level of caution in connection with their MD&A activity. *See* Pet. 76a–78a (listing client alerts and commentary). As this Court has recognized, "an avalanche of trivial information * * * is hardly conducive to informed decisionmaking." *Basic*, 485 U.S. at 231 (quoting *TSC Indus., Inc.* v. *Northway, Inc.*, 426 U.S. 438, 448–49 (1976)). "[A]n overabundance of information" is as big a problem for investors as too little. *Id.*

2. The Second Circuit's approach also has the counterproductive effect of increasing the frequency and cost of Section 10(b) litigation, a species that "presents a danger of vexatiousness different in degree and in kind" from other litigation. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 739 (1975). "[T]he mere existence of an unresolved lawsuit" relating to disclosure, even if it lacks merit, "has settlement value to the plaintiff * * * because of the threat of extensive discovery and disruption of normal business activities" to the defendant if the suit cannot be dismissed on the

papers. *Id.* at 742–43. Conversely, defendants' incentives to settle are more pronounced in this environment of uncertainty, where "[t]he issues would be hazy, their litigation protracted, and their resolution unreliable." *See Va. Bankshares*, 501 U.S. at 1106. Faced with the prospect of "expend[ing] large sums even for pretrial defense and the negotiation of settlements," it might be "prudent and necessary" for an issuer "to abandon substantial defenses" and settle instead. *Cent. Bank*, 511 U.S. at 189.

The looming threat of Section 10(b) liability can make it difficult for smaller companies to survive and for established companies to avoid passing the costs of compliance with uncertain requirements on to their investors—"the intended beneficiaries of the statute." *Id.* The Court should intervene to establish a uniform rule that reduces these risks, restores an appropriate amount of certainty to the market, and reflects the intent of Congress.

CONCLUSION

This case squarely presents the question left unanswered when *Leidos* settled. The Court should take this opportunity to resolve it now and grant the petition for a writ of certiorari.

Respectfully submitted.

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