Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—S. Ct.: Supreme Court mulls whether omission of “known trends and uncertainties” is securities fraud, (Jan 17, 2024)

By Lene Powell, J.D.

Justices probed whether this was a “pure omissions” case and what was required to prove a “half-truths” theory.

The U.S. Supreme Court heard oral argument on whether a failure to disclose “known trends and uncertainties” under Item 303 of Regulation S-K can give rise to a private securities fraud action. Justices explored whether Item 303 omissions require a misleading statement and if private rights of action are authorized in this context (*Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, January 16, 2024).

Adverse business trend. Petitioner Macquarie Infrastructure suffered a decline in demand for its bulk liquid storage service after a 2016 environmental regulation imposed new limitations. Two years later, Macquarie announced it was reducing its 2018 dividend guidance, triggering a stock drop of about 41 percent.

Moab Partners brought a securities fraud action alleging that Macquarie violated Item 303 of Regulation S-K, which requires disclosure of "known trends or uncertainties" reasonably likely to have a material impact on revenue. Moab argued that Macquarie improperly failed to disclose that the environmental regulation would have a negative impact on its financial performance. The district court sided with Macquarie, finding that Moab failed to point to an uncertainty that should have been disclosed and also failed to plead in which SEC filings it should have been disclosed.

The Second Circuit reversed, ruling that Moab adequately alleged a "known trend or uncertainty" giving rise to a duty to disclose under Item 303. This also sufficed to establish an actionable omission and scienter under Section 10(b) of the Exchange Act.

In a petition for certioriari, Macquarie asked if the Second Circuit erred in holding that failing to make a disclosure under Item 303 can support a private claim under Section 10(b), even in the absence of an otherwise-misleading statement. Macquarie said the question presented a circuit split, with the Third, Eleventh, and Ninth Circuits holding that a failure to disclose under Item 303 is not enough on its own to support a private cause of action; the Fifth Circuit has said in dicta that it has never held that Item 303 creates a duty to disclose. The petition also argues that the Supreme Court has repeatedly stated that the private right of action in the Exchange Act should not extend beyond its boundaries.

Misleading statement necesssary. At oral argument, counsel for Macquarie argued that Rule 10b-5 makes clear that an omission is actionable in just one circumstance—when the omitted fact is material and necessary to make a statement not misleading.

More narrowly, said Macquarie, the text does not permit eliding the "statement" requirement by treating the entire management narrative as misleading if one thing is left out.

Justice Kagan queried where the requirement came from that an omission must not make a statement misleading. Macquarie replied that the Private Securities Litigation Reform Act (PSLRA) requires that each statement be specifically identified in the complaint. Then, the defendant may defend, by, for example, invoking the safe harbor for forward-looking statements or citing *Omnicare* for a statement of opinion.

Justice Barrett asked if the rule Macquarie is asking for was “fairly narrow.” Macquarie said yes, it is simply asking that the complaint identify a misleading statement as required by the text of 10(b).

Justices Barrett and Kagan asked Moab if, under its theory, it would have to identify misleading statements. Moab

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said it was not arguing that it would not have to show misleading statements. In any case, said Moab, it did. The Management's Discussion and Analysis (MD&A) as a whole was made misleading by the omission, as well as more particularized statements within the MD&A.

Justice Jackson asked about half-truths. Could Item 303 give rise to liability if a company talked about various trends but left out a few that seemed pretty consequential if investors knew about them? Macquarie sidestepped, saying it was asking the court to "respect the text of Rule 10b-5(b)."

Justice Thomas asked if there was a limit to pure omissions being misleading. Moab said yes, the Second Circuit provided a decision tree as to violations of Item 303, which offered "prophylactic protections."

Justice Gorsuch delved into how specific a "statement" had to be. Moab replied that it agreed with the government that the PSLRA does not require individual sentences.

Private right of action. Macquarie said the Supreme Court has indicated it is loath to expand the judicially implied private right of action.

Chief Justice Roberts and Justice Kavanaugh pressed whether Macquarie was arguing that private actions could not be brought under Section 303 alone. Macquarie did not answer directly, instead returning to the point that a complaint must identify a misleading statement.

Chief Justice Roberts also asked the Assistant to the Solicitor General if the court should not be reluctant about extending a private right of action in this context. The SG replied that the government is not relying on a new theory, because the facts fit within the existing "half-truth" theory. The SG also believed the petitioners were over-reading the court's decisions in *Stoneridge* and *Janus* regarding expansion of the private right of action.

Justice Thomas asked if the SEC would still have authority over the omission if Moab lost. Moab said the SEC would not have 10b-5(b) fraud authority under the petitioners' theory, and in any case the SEC has made it clear that its enforcement staff is meager compared to the resources and opportunities for institutional investors to bring private actions.

Justice Kavanaugh asked the SG about the SEC's "meager resources." The SG agreed that the SEC's resources in this area are limited. The SG also noted that the court has repeatedly said that private litigation under Rule 10b-5 is an essential supplement to SEC enforcement actions.

This is case No. 22-1165.

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Companies: Macquarie Infrastructure Corp.; Moab Partners, L.P.; Barclays Capital Inc.

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