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Supreme Court holds that Item 303 pure omissions claims are not actionable under Rule 10b-5

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In *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, the Supreme Court held that an issuer's nondisclosure of information required by Item 303 of Regulation S-K cannot support a claim under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 unless that omission renders some other affirmative statement misleading.

Item 303 of Securities and Exchange Commission (SEC) Regulation S-K broadly requires public issuers to disclose material "known trends or uncertainties" that impact sales, revenue or income in the "Management, Discussion and Analysis" (MD&A) section of registration statements, annual and quarterly reports, and certain other filings. In recent years, plaintiffs have claimed that various companies have engaged in securities fraud under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5(b) by failing to disclose information ostensibly required to be disclosed under Item 303. A circuit split had developed between the Second Circuit, which had previously held that Item 303 violations could, under a pure omission theory, serve as the basis for Section 10(b) and Rule 10b-5 claims, and the Third, Ninth and Eleventh Circuits, which had all held that a plaintiff must identify a separate statement that was rendered misleading by the alleged Item 303 omission in order to have an actionable claim. On April 12, 2024, a unanimous Supreme Court held that securities fraud claims cannot be based solely on alleged Item 303 omissions.

Background

Macquarie Infrastructure Corporation (Macquarie), a public issuer, owned a subsidiary that operated bulk liquid storage terminals in the United States. One liquid stored in those terminals was No. 6 fuel oil, which had a high sulfur content. In 2016, the United Nations' International Maritime Organization adopted IMO 2020, a regulation that caps the sulfur content of fuel oil used in shipping at a level well below that of No. 6 fuel oil. In February 2018, Macquarie announced that the amount of storage capacity contracted for use by its subsidiary's customers had dropped in part due to the decline in the No. 6 fuel oil market. Macquarie's stock price fell approximately 41% following the announcement.

Moab Partners, L.P. (Moab), an investor in Macquarie, brought a putative securities class action against Macquarie alleging a violation of Section 10(b) and Rule 10b-5. Moab alleged that prior to 2018, Macquarie had concealed from investors that No. 6 fuel oil faced a worldwide ban due to IMO 2020. Moab further alleged that under Item 303, Macquarie was required to disclose the extent to which its subsidiary's business relied on the storage of No. 6 fuel oil and the pending risk to that business, and that Macquarie's alleged failure to do so was actionable under Rule 10b-5.

The district court dismissed Moab's complaint, and the Second Circuit reversed. The Second Circuit acknowledged that, for an omission to be actionable under Section 10(b) and Rule 10b-5, the issuer must have been under a duty to disclose the information in question. The Second Circuit held that such a duty arises when either (1) a statute or regulation such as Item 303 requires disclosure, or (2) disclosure is necessary to tell the whole truth about a particular subject on which an issuer speaks. The Second Circuit held that Moab adequately alleged a duty to disclose based on the alleged Item 303 violation standing alone.

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The Supreme Court's decision

Writing for a unanimous court, Justice Sotomayor vacated the Second Circuit's decision. The opinion examined the language of subsection (b) of Rule 10b-5 and in particular its prohibition on omitting a material fact necessary "to make the statements made … not misleading[.]" The Court held that this language prohibits half-truths, but not pure omissions. The Court illustrated the difference between pure omissions and half-truths with the example of a child who does not tell his parents that he ate a whole cake—a pure omission where the child is saying nothing—versus a child telling his parents he had dessert but omitting the fact that the dessert was a whole cake—a half-truth that speaks to the topic but omits critical information.

The Court contrasted the language in Rule 10b-5(b) with that of Section 11 of the Securities Act of 1933 (Securities Act), which prohibits any registration statement that "omit[s] to state a material fact *required to be stated therein* or necessary to make the statements therein not misleading" (emphasis added). The Court read this language as prohibiting both half-truths and pure omissions to the extent there is a regulatory or other legal obligation to disclose the omitted information. It also noted that similar language prohibiting pure omissions in violation of an existing duty to disclose was not included by Congress in Section 10(b) or by the SEC in Rule 10b-5. The Court concluded that interpreting Section 10(b) and Rule 10b-5 to cover pure omissions would render the distinct language of Section 11 superfluous. So, while pure omissions claims based on violations of Item 303 remain viable under Section 11, provided a plaintiff can sufficiently plead such violations, they are now foreclosed under Section 10(b) and Rule 10b-5.

The Court rejected Moab's contention that reversing the Second Circuit would create "broad immunity" from liability for the nondisclosure of negative business trends because (1) the SEC still retains the authority to pursue violations of Item 303; and (2) private parties may still bring claims based on Item 303 violations under Section 10(b) and Rule 10b-5 if those violations also create misleading half-truths.

Key takeaways

The Court's decision confirms the well-established limitations courts have placed on an omission theory of liability under Section 10(b) and Rule 10b-5. Plaintiffs have been attempting to expand the use of an omission theory by using Item 303 to broaden the scope of potential liability under Section 10(b) and Rule 10b-5. This decision makes plain that Section 10(b) and Rule 10b-5 do not cover pure omissions that are untethered to an issuer's actual statements. Consistent with the established law in the Third, Ninth, and Eleventh Circuits, plaintiffs in every circuit must now identify an affirmative statement that the omission allegedly made misleading. And they must do so with particularity under the heightened pleading standards of the Private Securities Litigation Reform Act of 1995 (the "PSLRA"). While plaintiffs will undoubtedly attempt to repackage what are fundamentally Item 303 pure omissions claims by trying to identify affirmative statements allegedly rendered misleading, the PSLRA's heightened pleading standards should foreclose efforts to plead a claim that would not otherwise have been viable as a misleading half-truth.

The Court's decision should also foreclose Item 303 pure omissions claims under Section 12(a)(2) of the Securities Act. Although the decision does not explicitly address Section 12 claims, the language of Section 12(a)(2), like the language of Rule 10b-5 (but unlike the language of Section 11), does not explicitly prohibit pure omissions.

It remains to be seen how lower courts, in practice, will construe the requirement that an Item 303 violation must render some affirmative statement misleading to be actionable under Section 10(b) and Rule 10b-5. For example, at oral argument in the Supreme Court, counsel disputed whether a plaintiff can allege that the entire MD&A section was, as a whole, rendered misleading by virtue of an Item 303 omission. However, the PSLRA, which requires fraud plaintiffs to "specify each statement alleged to have been misleading," should ensure that a plaintiff cannot comply with *Macquarie* by claiming that an entire section of a securities filing was misleading due to an alleged Item 303 violation. Indeed, the Supreme Court's decision made it clear that "[l]ogically and by its plain text, [Rule 10b-5] requires identifying *affirmative* assertions …" (emphasis added), which should foreclose attempts to claim that an issuer's MD&A as a whole was somehow rendered misleading by an alleged Item 303 omission.

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