Duties, Disclosure, and Discord: Necessity to Resolve Circuit Split and Certainty Leidos Could Have Clarified for Litigation Strategy and Risk Allocation

Damian P. Gallagher

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DUTIES, DISCLOSURE, AND DISCORD:
NECESSITY TO RESOLVE CIRCUIT SPLIT
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ABSTRACT

Securities litigation is a complex, specialized, and detailed practice of the law that depends on the expertise of courts and the Securities and Exchange Commission. From its inception, the securities laws, namely the Securities Act of 1933 and the Securities Exchange Act of 1934, provided a baseline expectation and prescription for the Securities and Exchange Commission to promulgate rules to fulfill the organic statute’s demands. Through time, technology, and the law generally, the securities laws have expanded significantly, not only asking, but also requiring, the courts to answer questions never contemplated by the original drafters of the laws to guide this industry.

This Note purports to explain the outcome of a case the United States Supreme Court granted certiorari to answer the reach of a promulgated regulation. Namely, whether Item 303 of Regulation S-K permits a Rule 10b-5 action for securities fraud through omitted statements. Because the parties themselves dismissed the

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lawsuit before the Supreme Court could actually answer the question, based on the circuit split and the Supreme Court’s current jurisprudence and outlook with the securities laws, this Note will suggest the impact Leidos could have had on the industry and the implications generally.
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INTRODUCTION

Without a doubt, the securities industry presents new problems for litigators to evaluate, argue, brief, and present new solutions. Time has only brought more questions, and as the courts attempt to answer these questions, it only leads to more ambiguities and subsequent follow-up questions.

After a traumatic economic crash and the tragedy of the Great Depression, Congress enacted the Securities Act of 1933 (Securities Act), and later the Securities Exchange Act of 1934 (Exchange Act), which created the Securities Exchange Commission (SEC). The Acts permit the SEC to promulgate rules to carry out the agency’s purpose. While the Acts cover a wide range of prohibitive activities and lawsuits, Section 10(b) of the Exchange Act is the applicable section that prohibits insider trading. Under the authority of Section 10(b), the SEC promulgated Rule 10b-5 to fulfill the statute’s mission.

It is clear that corporate insiders or individuals who have access to inside information have affirmative duties to disclose trades on such information or to abstain from trading from information; failure to comply with these duties can result in prosecutions under Section 10(b) and Rule 10b-5 for fraud, insider trading, or both, by the SEC or the Department of Justice. In other cases, courts have extended liability in cases where there is a material omission. This seems counterintuitive because, ordinarily, a failure to act does not trigger liability in the common law regime. So

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2 The SEC has described its mission “to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.” Additionally, the SEC was created in 1934 “to enforce the newly-passed securities laws.” U.S. SEC. AND EXCH. COMM’N, What We Do (June 10, 2013), https://www.sec.gov/Article/whatwedo.html [https://perma.cc/3AAM-TCU4].
3 Exchange Act § 78j.
how can someone violate the law by failing to act or even provide uncertain information? Violating the law in this scenario is more likely than one would imagine.

In *Leidos*, the Supreme Court of the United States granted certiorari to answer just this question: “[w]hether the Second Circuit erred in holding—in direct conflict with the decisions of the Third and Ninth Circuits—that Item 303 of SEC Regulation S-K creates a duty to disclose that is actionable under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.”

*Leidos* effectively offered the opportunity to answer whether Item 303 created an additional actionable duty under Section 10(b) and Rule 10b-5.

Previous scholarly work has addressed the circuit split that would later be granted certiorari by the Supreme Court. Further, “it is clear that harmonizing holdings in *Stratte-McClure* and *Cohen* into a single coherent legal principle does not stretch limits of logical possibility.” This premise perfectly illuminates the opportunity that *Leidos* could have offered had it not been dismissed under Supreme Court rules.

This Note aims to assess the parties’ arguments in *Leidos*, which the Supreme Court would have addressed had it ruled on the merits of the case. Part I will discuss the essential statutory background in the securities law world, including necessary provisions, the growth of Rule 10b-5, and the normative policy arguments that guide the federal securities laws. Moreover, it will evaluate Item 303 and Private Shareholder Litigation suits. Scholarly discussion on Item 303 and the interplay of Rule 10b-5 and private enforcement actions will further set the stage for *Leidos*. Part II tackles a potential holding where the various iterations

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9 Id.

10 See Brian Currie, Note, *Much Ado About Nothing: The Limits of Liability For Item 303 Omissions and the Circuit Split That Never Was*, 8 WM. & MARY BUS. L. REV. 379, 404–05 (2017) (finding that there never actually was a circuit split because the Second Circuit and the Ninth Circuit “based their decisions upon similar readings of the same cases,” and “[i]t seems that [the split] is merely a story of a circuit court split that simply never existed—but created a stir nonetheless”) (alteration in original).

11 Id.

12 See infra Part I.

13 See infra Part I.
of the cases are described in detail to vet out the factual and legal background behind the cases.\textsuperscript{14} Subsequently, Part III articulates both the Petitioner’s and Respondent’s arguments on the question granted for certiorari.\textsuperscript{15} With this background, Part IV fleshes out the various Circuit Court of Appeal opinions that create the circuit split outlined in the Petitioner’s and Respondent’s arguments.\textsuperscript{16} Part V will attempt to assess what the Supreme Court could have held were the case not dismissed.\textsuperscript{17} Finally, the Conclusion catalogues the impact that a ruling in \textit{Leidos} could have in the securities law world.\textsuperscript{18} Policy arguments will be framed around a chilling effect on disclosure, better market pricing for the fundamental value of stocks, litigation cost analytics in private plaintiff suits, and finally, an assessment of risk allocation and litigation certainty.

I. ESSENTIAL STATUTORY BACKGROUND AND SECURITIES LAW PROVISIONS

In order to understand \textit{Leidos}, it is integral to understand the securities law landscape, statutes, and applicable rules that give rise to duties. This Part will first provide a detailed assessment of the Securities Act and the Exchange Act. Second, this Part will unravel Rule 10b-5, the elements to bring such an action, and some scholarly commentary on Rule 10b-5 generally. Third, this Section will scrutinize Regulation S-K’s Item 303, the provision’s language, SEC commentary, and additional information to truly comprehend the disclosure requirement. Subsequently, Part I will explain the nature of private shareholder litigation when in reference to Item 303.

Both the Securities Act of 1933\textsuperscript{19} and the Securities Exchange Act of 1934\textsuperscript{20} were designed to combat fraud and protect investors generally after the catastrophic stock market crash in

\textsuperscript{14} See infra Part II.
\textsuperscript{15} See infra Part III.
\textsuperscript{16} See infra Part IV.
\textsuperscript{17} See infra Part V.
\textsuperscript{18} See infra Conclusion.
1929. While the 1933 Act certainly is important, it only applies to the purchase of securities, whereas the 1934 Act applies to the purchase or sale of securities. Section (b) of the Exchange Act prohibits entities:

To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange ... any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Based on an initial reading, even scholars generally recognize that the provision is not clear in what it proscribes. Because there is an apparent lack of legislative history or rather, the record is not sufficient to allow scholars to glean meaning, scholars have ascertained that Section 10(b) has two conceptions. The “Prevailing Conception” comes from the Supreme Court’s narrow construction of Section 10(b)’s language and prohibition of broad prosecuting power. The article cites to the Supreme Court’s reading of Section 10(b) in Ernst & Ernst v. Hochfelder, which relied on “any manipulative device or contrivance” as a necessarily broad proscription instead of enumerated devices in order to “fulfill the

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24 See Steve Thel, The Original Conception of Section 10(b) of the Securities Exchange Act., 42 STAN. L. REV. 385, 386 (1990) (“It would be very hard to define exactly what section 10(b) and rule 10b-5 forbid. It is surely impossible to say in a nutshell.”).
25 Id. at 388 (“Although the Court had declared that the history of section 10(b) supports its [narrow] reading, it usually added that section 10(b) has almost no history.”). Their notes that the Supreme Court has discussed the legislative history in footnote 15. Id. (discussing Aaron v. SEC, 446 U.S. 680, 690 (1980); Ernst & Ernst v. Hochfelder, 425 U.S. 185, 201–06 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975)).
26 Id. at 386.
27 Id.
objectives of the Exchange Act.” The Court then limited the broad language to certain cases of “misconduct involving deception, misrepresentation, or nondisclosure.” Steve Thel’s “Alternative Conception” is the 1934 Act’s concern for securities pricing since the Act considers “several critical factors affecting prices including production and dissemination of information that might affect prices, the flow of money into and out of the market, and the basic structure of the securities market.” But regardless of the history used to support either conception, the individuals who debate which conception prevails all seem to agree that the “Act conferred open-ended rulemaking authority on the SEC.”

One thing is clear with regard to Section 10(b): the SEC promulgated Rule 10b-5 as a result of the statute’s language. Rule 10b-5 makes it:

[U]nlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce ... (a) to employ any device, scheme, or artifice to defraud, (b) to make any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made ... not misleading, or (c) to engage in any act ... which operates or would operate as fraud or deceit upon any person ....

With the securities statutory landscape explained, the question before the Court, here, is about Regulation S-K and Item 303. Regulation S-K largely handles the filing of nonfinancial statements in accordance with the prescribed securities laws and SEC Interpretive Releases. The regulation states that this section is concerned with registrant’s future projections. When management makes such projections, they must have a “good faith

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29 Thel, supra note 24, at 387.
30 Id. at 388.
31 Id. at 391 (“The theme that ties the Act together is a concern with securities prices.”).
32 Id. at 394.
33 17 C.F.R. § 240.10b-5 (1951).
34 Id.
36 17 C.F.R. § 229.10(a) (2019).
37 Id. § 229.10(b) (“The Commission encourages the use in documents ... of managements projection of future economic performance that have a reasonable basis and are presented in an appropriate format.”).
assessments” of the foreseeable performance and also “have a reasonable basis for such an assessment.”\footnote{Id. § 229.10(b)(1).} The regulation emphasizes the importance of communicating clearly to the investor, especially with previous projections:

With respect to previously issued projections, registrants are reminded of their responsibility to make full and prompt disclosure of material facts, both favorable and unfavorable, regarding their financial condition. This responsibility may extend to situations where management knows or has reason to know that its previously disclosed projections no longer have a reasonable basis.\footnote{Id. § 229.10(b)(3)(iii).}

Broadly speaking, Regulation S-K is predicated on the importance of providing transparency to the investor.\footnote{Id. § 229.10(b)(1) stating:

[t]he Commission also believes that investor understanding would be enhanced by disclosure of the assumptions which in management’s opinion are most significant to the projections or are the key factors upon which the financial results of the enterprise depend and encourages disclosure of assumptions in a manner that will provide a framework for analysis of the projection.} Or more simply, the regulation is investor-focused.

The broad intentions and prescriptions of Regulation S-K aid the understanding of Section 229.303, which is commonly referred to as Item 303.\footnote{Id. § 229.303.} Item 303’s title refers to “[m]anagement’s discussion and analysis of financial condition and results of operations” (usually simplified as MD&A).\footnote{Id.} The regulation is predominantly concerned with five areas of management’s disclosure: liquidity, capital resources, results of operations, off-balance sheet arrangements, and tabular disclosure of contractual obligations.\footnote{Id. § 229.303(a)(1)–(5).} For transparency’s sake, the regulation requires for management to “[d]iscuss [the] registrant’s financial condition, changes in financial condition and results of operations.”\footnote{Id. § 229.303(a).}

Objectively, Item 303 imposes affirmative requirements with which managers must comply.\footnote{Id.} For example, the registrant must

\begin{itemize}
  \item \footnote{Id. § 229.10(b)(1).}
  \item \footnote{Id. § 229.10(b)(3)(iii).}
  \item \footnote{Id. § 229.10(b)(1) stating:

[t]he Commission also believes that investor understanding would be enhanced by disclosure of the assumptions which in management’s opinion are most significant to the projections or are the key factors upon which the financial results of the enterprise depend and encourages disclosure of assumptions in a manner that will provide a framework for analysis of the projection.}
  \item \footnote{Id. § 229.303.}
  \item \footnote{Id.}
  \item \footnote{Id. § 229.303(a)(1)–(5).}
  \item \footnote{Id. § 229.303(a).}
  \item \footnote{Id.}
report “any unusual or infrequent events or transactions or any significant economic changes” that could have a material impact on reported income. Further, the regulation requires registrants to “[d]escribe any known trends or uncertainties” that the registrant would reasonably believe to have a material impact on net sales and revenues. Largely, the burden rests with the registrant to make decisions that could be tangentially related.

These forward-looking statements have been conceptualized in the academic community. Even with the clear statutory language, “at first blush the regulation seems to require disclosure of all forward-looking information; the use of the word ‘known’ operates purportedly as a distinction for disclosures grounded in current knowledge and purely predictive disclosures.” Setting aside the elements of a securities fraud private cause of action, it is unclear to courts “whether all required Item 303 disclosures are material under the federal securities laws.”

Scholars have tried to answer this very question of materiality and whether Item 303 violations are sufficient for the elements to be pleaded. Claiming that Item 303 does not cross the materiality threshold required by case law (see Basic v. Levinson), Matthew Ady believes that there are real litigation hurdles for Item 303–based causes of action. One such barrier is the lack of recovery for speculated damages coupled with “strict standards

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46 Id. § 229.303(a)(3)(i).
47 Id. § 229.303(a)(3)(ii).
48 Id. § 229.303(a) (“Where in the registrant’s judgment a discussion of segment information and/or of other subdivisions (e.g., geographic areas) of the registrant’s business would be appropriate to an understanding of such business, the discussion shall focus on each relevant, reportable segment and/or other ... as a whole.”).
49 See Brian Neach, Note, Item 303’s Role in Private Causes of Action Under the Federal Securities Laws, 76 NOTRE DAME L. REV. 741, 741 (2001) (“Stated simply, a ‘forward-looking statement’ in the context of securities law represents a statement ‘describing events or activities that will occur, if at all, at some future date.’” (quoting James D. Cox et al., SECURITIES REGULATION: CASES AND MATERIALS (2d ed. 1997))).
50 Id. at 744.
51 Id. at 752.
54 Ady, supra note 52, at 433.
set by PSLRA and the Supreme Court ...."55 While private causes of action may be limited for plaintiffs, the author does note that the SEC can still circumvent the 10b-5 action by way of a mere Item 303 violation.56 By analyzing studies evaluating the necessary threshold of what percentage would be necessary for “reasonably likely,” Ady quite simply states “Item 303 would mandate disclosure of that uncertainty.”57

Other scholars take a less measurable approach to materiality and instead focus on the implications of failing to effectively litigate Item 303 violations.58 Such shortfalls result in less information being available to investors, less efficient markets, and less informed investment decisions.59 While encouraging more enforcement of Item 303 as private 10b-5 causes of action, Suzanne Romajas claims and supports the notion that “the SEC’s general position [is] that not all forward-looking information must be disclosed.”60 The SEC has taken steps through interpretive releases to explain what the Item 303 standard is for MD&A; however, “the standards for disclosure, particularly as they relate to forward-looking information, remain uncertain.”61

II. SPLIT CIRCUITS AND SETTING THE STAGE FOR LEIDOS

Part of the Supreme Court’s essential calculus for granting certiorari is the existence of a circuit split. “A conflict among the circuits is probably the most important criterion for the grant of certiorari.”62 Such splits are often viewed as troubling.63 This Part

55 Id. at 433–34.
56 Id. at 434 (“Pursuant to the Exchange Act, the SEC may impose a civil fine on companies that violate Item 303, and it often does.”).
57 Id. at 429.
59 Id.
60 Id. at 257.
61 Id. at 286.
62 Marybeth Herald, Reversed, Vacated, and Split: The Supreme Court, the Ninth Circuit, and the Congress, 77 OR. L. REV. 405, 431 n.130 (citing H.W. Perry, Jr., Deciding to Decide: Agenda Setting in the United States Supreme Court, 100 (1991)).
63 Id. at 431 (“[C]ircuit splits are unseemly and unsettling because at least two panels of learned judges have come to opposite conclusions on a legal point. Although lawyers may thrive on the absence of a clear rule, the public perception may be that the system is irrational and unfair.”).
aims to walk through the split between the Second Circuit, the Third Circuit, and the Ninth Circuit, focusing on the legal analysis behind the split. Specifically, this Part focuses on emphasizing the factual distinctions made in the Second Circuit’s analysis of Regulation S-K because it was the Circuit Court that drew attention to the split.

A. The Second Circuit

In *Stratte-McClure v. Morgan Stanley*, the Second Circuit held, as a matter of first impression, “that a failure to make a required Item 303 disclosure in a 10-Q filing is indeed an omission that can serve as the basis for a Section 10(b) securities fraud claim.”64 Arriving at such a conclusion, the Second Circuit recognized that generally, “[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5.”65 But while this common law concept does not impose liability absent a duty to disclose, Item 303 imposes an affirmative duty to disclose in Form 10-Qs, and fraud in these filings *can* constitute fraud under Section 10(b).66 The Second Circuit noted that “[w]e have already held that failing to comply with Item 303 by omitting known trends or uncertainties from a registration statement or prospectus is actionable under Sections 11 and 12(a)(2) of the Securities Act of 1933.”67 Citing Section 12(a)(2) of the Securities Act of 1933, the Second Circuit pointed out that the language tracks similar verbiage in Rule 10b-5, which requires disclosure of “material fact[s] necessary in order to make ... statements made ... not misleading.”68 By virtue of the requirement that entities use affirmative disclosure of information to avoid making registration statements and filings misleading, the court ascertained that “omitting an item required to be disclosed on a 10-Q can render that financial statement misleading.”69 Further, the court grounded its reasoning that an omission can be as misleading as affirmative statements because these disclosures “give investors an opportunity to look at the registrant through

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64 776 F.3d 94, 100 (2d Cir. 2015).
66 776 F.3d at 101.
67 776 F.3d at 101.
68 776 F.3d at 101.
69 776 F.3d at 101.
the eyes of management by providing a historical and prospective analysis of the registrant’s financial condition and results of operations.”\textsuperscript{70} Since Item 303 and disclosures generally offer investors an opportunity to assess the registrant, such an investor “would interpret the absence of an Item 303 disclosure to imply the nonexistence of ‘known trends or uncertainties ...’”\textsuperscript{71}

The court proceeded, stating that sustaining an omission claim under Item 303 will only prevail under Rule 10b-5 if the omission would be “material” under the Rule.\textsuperscript{72} This requires the private plaintiff bringing the action to demonstrate that the defendant failed to meet Item 303’s requirements.\textsuperscript{73} Then, the plaintiff must show that the defendant had such a duty to disclose the omission under Item 303, followed by a showing that the omission was material.\textsuperscript{74}

The Second Circuit forwardly recognized that its conclusion—that an omission under Item 303 could give rise to liability—is incompatible with differing conclusions in the Ninth and Third Circuits.\textsuperscript{75} The Second Circuit addressed the Third Circuit’s confusing standard in \textit{Oran},\textsuperscript{76} which some courts believed it to hold that an Item 303 omission “does not automatically give rise to a material omission under Rule 10b-5”\textsuperscript{77} and clarified that the Third Circuit actually held that Item 303 \textit{could} give rise to a material 10b-5 omission standard.\textsuperscript{78} The Second Circuit determined that the Third Circuit’s holding is consistent with its opinion in the fact “[a]t a minimum, \textit{Oran} is consistent with our decision that failure to comply with Item 303 ... can give rise to liability under Rule 10b-5 so long as the omission is material ....”\textsuperscript{79}

In applying the legal standard it deemed appropriate for omissions under Item 303, the Second Circuit affirmed the District

\textsuperscript{72} \textit{Stratte-McClure}, 776 F.3d at 102.
\textsuperscript{73} \textit{Id.} at 103.
\textsuperscript{74} \textit{Id.}
\textsuperscript{75} \textit{Id.}
\textsuperscript{76} \textit{Oran} v. \textit{Stafford}, 226 F.3d 275, 288 (3d Cir. 2000).
\textsuperscript{77} \textit{Stratte-McClure}, 776 F.3d at 103 (quoting \textit{Oran} v. \textit{Stafford}, 226 F.3d 275 (3d Cir. 2000)) (emphasis in original).
\textsuperscript{78} \textit{Id.} at 103 (emphasis in original).
\textsuperscript{79} \textit{Id.} at 103–04.
Court’s dismissal of the claim because of plaintiff’s pleading shortcomings.\textsuperscript{80} However, the court, addressing the merits, also found that the defendants \textit{did} breach the duty imposed by Item 303 because the defendant (Morgan Stanley) faced a deteriorating market and failed to disclose future trading losses “that would materially affect the company’s financial condition.”\textsuperscript{81} Morgan Stanley rebutted plaintiff’s claim that its Item 303 disclosure was inadequate with the fact that Morgan Stanley did, in fact, disclose in reference to deterioration of positions in other markets.\textsuperscript{82} But the court found that the disclosure trends were “generic,” “spread out,” and “unconnected to the company’s financial position.”\textsuperscript{83} The court reiterated the SEC’s expectation and Item 303’s imposition that disclosures include both a “discussion” and an “analysis” to be sufficient.\textsuperscript{84}

As such, the Second Circuit held that omitted information fails to comply with the demands of Item 303 and this constitutes an actionable fraud suit.\textsuperscript{85} This holding, different from the Ninth Circuit below, widens the circuit split that gave rise to \textit{Leidos}.\textsuperscript{86} Should the Supreme Court side with the Second Circuit approach, the court which has been referenced as the “Mother Court” for securities,\textsuperscript{87} then liability would be greatly expanded through omitted information that an investor would reasonably want to know.

\textbf{B. The Ninth Circuit}

The Ninth Circuit, in \textit{NVIDIA Corp.}, held that Item 303 did not create a duty to disclose under the applicable statutes at play.\textsuperscript{88} The court grounded its reasoning in the required duties

\textsuperscript{80} Id. at 106.
\textsuperscript{81} Id. at 104.
\textsuperscript{82} Id. at 105 (“[D]isclosing the deterioration of the real estate, credit, and sub-prime mortgage markets, and its potential negatively to affect Morgan Stanley.”).
\textsuperscript{83} Id.
\textsuperscript{84} Id. (citing 17 C.F.R. § 229.303(a)(3)(ii)).
\textsuperscript{85} Id. at 107.
\textsuperscript{88} In re NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1055 (9th Cir. 2014).
that typically give rise to a violation of Section 10(b) and Rule 10b-5.\textsuperscript{89} Essentially, relying on established principles, the court asserted that liability under the applicable statutes can only arise “from an omission in contravention of an affirmative legal disclosure obligation.”\textsuperscript{90} In the ordinary application of the law, the court noted that Section 10(b) and Rule 10b-5 do not create such an obligation “unless omission of that information would cause other information that is disclosed to be misleading.”\textsuperscript{91}

The court proceeded to address the plaintiff’s citation to Simon v. American Power-Conversion Corp., a case in which the judge found that Item 303 does create an affirmative duty to disclose and that the defendant’s failure to disclose created an actionable claim.\textsuperscript{92} However, the Ninth Circuit noted that the judge in Simon later clarified his opinion, writing that “[a]s this Court noted in Simon, the disclosure rules are probative of what defendants are otherwise obliged to disclose but do not, themselves, provide an independent duty of disclosure.”\textsuperscript{93} The court then concludes, on the same case, that a plaintiff cannot rely on an Item 303 omission to prove that a defendant’s omitted information was material.\textsuperscript{94} The court concluded that Item 303 “does not create a duty to disclose for purposes of Section 10(b) and Rule 10b-5” and that a separate duty must be shown through principles in Basic and Matrixx Initiatives.\textsuperscript{95}

The Ninth Circuit recognized and was “persuaded by [Oran’s] reasoning” in ascertaining the proper ruling on an Item 303 omission giving rise to a violation of Section 10(b) and Rule 10b-5.\textsuperscript{96} The court was persuaded by the varying tests required in Item 303 and the materiality principles established in Basic.\textsuperscript{97}

\begin{itemize}
\item \textsuperscript{89} Id.
\item \textsuperscript{90} Id. at 1055–56 (quoting Panther Partners v. Ikanos Comm., Inc., 681 F.3d 114, 120 (2d Cir. 2012)).
\item \textsuperscript{91} Id. at 1056 (citing Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 43 (2011)).
\item \textsuperscript{92} Id. (referencing Simon v. Am. Power Conversion Corp., 945 F. Supp. 416 (D.R.I. 1996)).
\item \textsuperscript{93} Id. (quoting Kafenbaum v. GTECH Holdings Corp., 217 F. Supp. 2d 238, 249 (D.R.I. 2002)).
\item \textsuperscript{94} Id.
\item \textsuperscript{95} Id.
\item \textsuperscript{96} Id. at 1054.
\item \textsuperscript{97} Id. at 1055.
\end{itemize}
that Item 303 requires more disclosure than what *Basic* requires, “what must be disclosed under Item 303 is not necessarily required under the standard in *Basic*.”

The court proceeded to adopt the *Oran* ideology that an Item 303 material omission does not certainly give rise to a 10b-5 violation.

### C. The Third Circuit

The Third Circuit’s *Oran* decision affords a closer relationship to the holding of the Ninth Circuit than the Second Circuit case, but equally complicates the circuit split. “[T]he ‘demonstration of a violation of the disclosure requirements of Item 303 does not lead inevitably to the conclusion that such disclosure would be required under Rule 10b-5. Such a duty to disclose must be separately shown.’” The court tried to wrestle between the competing statements offered in traditional 10b-5 analysis and the SEC’s interpretation of Item 303. Noting that the SEC’s interpretation of Item 303 “varies considerably from the general test for securities fraud materiality set out by the Supreme Court in *Basic, Inc. v. Levinson*[,]” the court was nevertheless convinced that the materiality requirements for a 10b-5 action do not give deference to a presumption that an Item 303 shortcoming establishes actionable fraud. Convinced by the findings in the SEC’s discussion that “[d]isclosure 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 court asserted that “SK-303’s disclosure obligations extend considerably beyond those required by Rule 10b-5.”

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98 *Id.*
99 *Id.* (quoting *Oran v. Stafford*, 226 F.3d 275, 288 (3d Cir. 2000)).
100 *Oran v. Stafford*, 226 F.3d 275, 288 (3d Cir. 2000).
102 *Oran*, 226 F.3d at 287.
103 *Id.* at 288.
104 *Id.* at 287–88.
Thus, the Third Circuit effectively held that violating Regulation S-K’s Item 303 “does not automatically give rise to a material omission under Rule 10b-5.”

D. Thoughts on Which Circuit Got It Right

Each Circuit’s approach has its virtues and vices. Without getting too mired in the thoughts on which the courts’ opinions were predication and, perhaps, the political underpinnings of the courts themselves, it would seem that the Supreme Court would prefer the Second Circuit approach. This makes sense for a few practical reasons. First, the Southern District of New York and the Second Circuit handle a large amount of securities-related actions. Not only is a Regional Office of the Securities and Exchange Commission stationed in New York City, but these enforcement actions along with private enforcement actions are tried and appealed regularly in these courts. Practically, the courts that frequently adjudicate these matters would be in the best position to determine the law. Further, the Second Circuit approach construes the securities laws liberally, which is both a common statutory interpretation approach and policy decision.

On the other hand, the Third and Ninth Circuit are reserved in expanding liability. Private parties would prefer this reading of Regulation S-K. It is more predictable and does not force companies to over-disclose in fear of litigation.

What might lend more insight to this inquiry are the arguments put forth by the Petitioner and Respondent for the Leidos case.

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105 Id. at 288.

106 See Stephen M. Bainbridge & G. Mitu Gulati, How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions, 51 Emory L.J. 83, 85 n.6 (2002) (“Instead, the real experts are the district court judges in the districts in New York ... who see securities fraud cases as a routine matter.”).


III. THE PETITION FOR WRIT OF CERTIORARI

In the Petition for a Writ of Certiorari, the question presented was “[w]hether the Second Circuit erred in holding—in direct conflict with the decisions of the Third and Ninth Circuits—that Item 303 of SEC Regulation S-K creates a duty to disclose that is actionable under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.”109

A. Petitioner’s Arguments

In its Brief for a Writ of Certiorari,110 the Petitioner framed the question presented with an emphasis on whether Item 303 created a newly enforceable duty under Rule 10b-5 in order to find that no such actionable duty exists.111 Petitioner argued first, that Item 303 of Regulation S-K does not create an actionable duty for private class action suits and second, that policy considerations are insufficient arguments to impose liability based on the securities laws’ “text and structure.”112

Petitioner’s first argument relies on Basic v. Levinson’s assertion that “[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5[ ]”113 and thus does not create a private cause of action.114 The Court has only recognized an actionable duty in two situations. First, where there is an affirmative duty not to mislead.115 So, for an omission to be actionable, as stated by Matrixx Initiatives, Inc. v. Siracusano,116 that omission must make an affirmative statement misleading.117 “A pure omission—where no statement is made at all—is not actionable.”118 Second, when

109 Id. at i.
110 In more than one way, the arguments have been simplified to the extent necessary to provide the most substantive and legally relevant facts for a discussion later in this Note. For any further reference or clarity, evaluate the Petitioner’s brief as cited within this Section.
112 Id. at 14, 17.
114 Brief for Petitioner, supra note 111, at 14.
115 Id. at 15 (citing Basic v. Levinson, 485 U.S. 224, 240 n.18 (1987), and the “duty not to mislead”).
117 Id. at 44.
118 Brief for Petitioner, supra note 111, at 15.
a relationship of trust and confidence exists, there is a fiduciary duty to disclose.119

In cases where the Court has recognized enforceable duties, “[it] has found an actionable disclosure duty in only two scenarios, and both involve something more than an omission itself.”120 As previously mentioned, the first variety is supported by Section 10(b)’s text and common law fraud principles, which is a duty to not mislead because “[t]he focus remains on the statement, not on the omission.”121 The Petitioner emphasized the notion that this variety of duties or obligations requires affirmative misrepresentations and “does not encompass the type of ‘pure omissions’ alleged by [Respondents] here.”122

Petitioner cited to cases, including Basic, opining this foundational concept of the securities industry, but further emphasized the context in the private action through Congress’s enactment of the Private Securities Litigation Reform Act (PSLRA).123 Petitioner stated that when Congress enacted PSLRA, it adopted Rule 10b-5(b)’s assertion that omissions can become actionable “only if an affirmative statement is rendered misleading.”124 The PSLRA codified a very limited set of misleading statements: just false statements amounting to half-truths as well as typical affirmatively misleading statements.125 Further, Petitioner not only argued that Plaintiff-Respondents failed to specify how each statement could be misleading (a statutory requirement under the PSLRA126), but also succinctly contended, “[a] pure omission claim cannot satisfy the PSLRA’s” pleading necessities.127

Petitioner’s second argument, relying on the fiduciary duty to disclose, rested on the understanding stated in Chiarella128

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119 Id. (citing Chiarella v. United States, 445 U.S. 222, 235 (1980)).
120 Id. at 20 (emphasis in original).
121 Id. at 21 (citing Basic v. Levinson, 485 U.S. 224, 240 n.18 (1987), and In re Vivendi, S.A. Sec. Litig., 838 F.3d 223, 240 (2d Cir. 2016)).
123 Id. at 24.
124 Id.
125 Id.
126 Id.
127 Id.
128 Chiarella v. United States, 445 U.S. 222, 235 (1980) (holding that “a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic
that relationships of trust and confidence create a duty to either disclose or abstain from disclosing. A derivation of common law fraud, *caveat emptor*, this duty created an obligation to disclose material nonpublic information to insiders before trading, or otherwise, abstain from acting on such information. The Court has permitted such a dealing to arise through legal obligations or courses of dealing other than a duty to comply with the federal securities antifraud principles.

After recognizing that the duties applicable to private rights of actions are limited in these two contexts, the Petitioner stated that the Second Circuit erred by creating an actionable third duty. This third duty permits an action through a “registrant’s silence where Item 303—or presumably any of the Commission’s *thousands* of other disclosure requirements—allegedly mandates that the information be disclosed.” Essentially, Petitioner argued that the Second Circuit expanded the statutory proscription in both section 10(b) and Rule 10b-5 “well beyond the boundaries established by Congress to include a liability theory that no court of appeals had held was actionable before the PSLRA was enacted.” The Petitioner grounded this argument in statutory language as well as the fact that it is the Commission’s responsibility to execute securities laws through enforcement proceedings, not private actions.

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130 *Id.* at 26 (citing case discussion on difference between applying pure omissions between 10b-5(a), 10b-5(b), and 10b-5(c), finding that 10b-5(a) and (c) required something more than just a pure omission).
131 *Id.* at 27 (citing Dirks v. SEC, 462 U.S. 646, 665 (1983), and noting that there, there was no prior dealing with the target company to create an actionable duty).
132 *Id.* at 27–28 (“This case involves neither duty. The operative complaint specifies no statement in the March 2011 10-K that was rendered misleading by the omission of the CityTime fraud; and SAIC had no fiduciary-type duty to disclose this information to aftermarket investors. That should have been the end of the § 10(b) analysis.”).
133 *Id.* at 28.
134 *Id.*
135 *Id.* at 28–29.
Among the statutory and legal support that Petitioner cited, Petitioner also substantiated its argument through public policy rationale.\textsuperscript{136} Its policy arguments included: an impediment to the current disclosure regulation regime through private enforcement actions and the fact that it would also encourage hindsight-driven litigation.\textsuperscript{137}

By implication from the Brief, the SEC has an interest in managing its disclosure requirements, and it has particular intentions when it enacts regulations (like S-K): “[t]he Commission’s goal has been to make Item 303 a vehicle for meaningful disclosure.”\textsuperscript{138} Additionally, “[p]rivate enforcement of Item 303 pure omissions ... would affirmatively incentivize registrants to flood the market with immaterial and premature disclosures.”\textsuperscript{139} “[I]nvestors would be buried ‘in an avalanche of trivial information.’”\textsuperscript{140} This would lead to poorer decision making, could reduce incentives, and also reduce market participation generally.\textsuperscript{141} Registrants would over-disclose to avoid litigation, which would “engender market confusion or competitive losses that justified withholding the information in the first place.”\textsuperscript{142}

On the point of hindsight-driven litigation, Petitioner argued that PSLRA was prescribed specifically to manage the private suits, and concerns of consistently filed litigation were even included in the House Reports.\textsuperscript{143} The third duty from the Second Circuit, Petitioners argued, would permit expanding litigation for plaintiffs “even without alleging a misleading statement or the reason why the statement is misleading, as expressly required by the PSLRA.”\textsuperscript{144} And if legitimized with Item 303, the holding could be expanded for the “thousands of separate and distinct reporting requirements.”\textsuperscript{145} Such a holding, if constitutionalized and set for precedent, could harm the legitimacy of the SEC to do its work

\textsuperscript{136} Id. at 41.
\textsuperscript{137} Id. at 47–48.
\textsuperscript{138} Id. at 42–43.
\textsuperscript{139} Id. at 44.
\textsuperscript{140} Id. at 45 (quoting Basic v. Levinson, 485 U.S. 224, 231 (1987) (internal citations omitted)).
\textsuperscript{141} Id.
\textsuperscript{142} Id. at 47.
\textsuperscript{143} Id.
\textsuperscript{144} Id. at 48.
\textsuperscript{145} Id. at 49.
through its disclosure regime and even complicate the SEC’s work for updating the requirements it seeks to enforce.\textsuperscript{146}

\textbf{B. Respondent’s Arguments}

This Section aims to dissect and explain Respondent’s arguments submitted to the Supreme Court. In some aspects, the arguments are simplified for the purposes of this Note, and for further analysis, please review the brief in its entirety.\textsuperscript{147}

The Respondent, expectedly, framed the question presented so as to create a duty through omission.\textsuperscript{148} The argument Respondent presented is twofold. First, by omitting required information as dictated by Regulation S-K, the issuer in fact engages in a deceptive action.\textsuperscript{149} Second, permitting liability through deceptive omissions actually advances Congress’s favored practice of disclosure.\textsuperscript{150}

Respondent substantiated its first argument that omissions are deceptive by claiming that annually required information is material and that omitting that information is deceptive through the statutory language of section 10(b) and Rule 10b-5.\textsuperscript{151} “As its text demonstrates, [section] 10(b) broadly prohibits the use of ‘any ... deceptive device or contrivance.’”\textsuperscript{152} As Respondent noted, investors rely on annually filed reports and “can be led to believe (incorrectly) that the omitted facts do not exist ....”\textsuperscript{153} Thereby, investors are accepting the annual report as facially valid and as “a truthful depiction.”\textsuperscript{154} By relying on the statutory language, Respondent further cited to \textit{Omnicare},\textsuperscript{155} noting that in assessing

\textsuperscript{146} \textit{Id.}
\textsuperscript{148} \textit{Id.} at i (“Whether an issuer of publicly traded securities that deceptively omits from a securities filing material information required to be disclosed under Item 303 of SEC Regulation S-K violates [section] 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.”).
\textsuperscript{149} \textit{Id.} at 21.
\textsuperscript{150} \textit{Id.} at 45.
\textsuperscript{151} \textit{Id.} at 21.
\textsuperscript{152} \textit{Id.} at 21–22 (citing 15 U.S.C. § 78j(b)).
\textsuperscript{153} \textit{Id.} at 22.
\textsuperscript{154} \textit{Id.}
whether a fact is material depends on the perspective of a reasonable investor.\textsuperscript{156} The Respondent asserted that “if a registration statement omits material facts about the issuer’s inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself, then [the applicable section’s] omissions clause creates liability.”\textsuperscript{157} In essence, Respondent tried to articulate that a similar approach should be applied here because investors assess statements from registrations as true or, at the very least, as forthright representations of the company’s current state.\textsuperscript{158}

Much of the Respondent’s argument relies on the assertion that by deliberately omitting material information as required by the SEC’s disclosure regime, such omissions are deceptive.\textsuperscript{159} This argument is substantiated by several facts that the Respondent pointed to: investors’ expectations that frequent filings are required by the SEC, the filing’s cover page including the SEC’s name, and certifications by the executive officers.\textsuperscript{160} Due to investors’ reliance on such filings, omitted information is deceptive.\textsuperscript{161} Respondent then provided an example that if executives failed to disclose a criminal proceeding against one of them, the reader would assume that no such proceeding is actually happening, thus making the failure to disclose deceptive.\textsuperscript{162} Respondent then makes its argument, in regard to Item 303 and MD&A, that it is such an important section for investors because it provides investors the opportunity to evaluate the registrant and make informed decisions.\textsuperscript{163} Here, the Petitioner’s MD&A was sixteen pages and aims to provide analyses of trends or uncertainties to the extent that they would have “a material impact” on the registrant and if anything is

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{156} Brief for Respondent, supra note 147, at 22 (citing Omnicare, 135 S. Ct. at 1327).
\item \textsuperscript{157} Id. (citing Omnicare, 135 S. Ct. at 1329).
\item \textsuperscript{158} Id. at 23–24.
\item \textsuperscript{159} Id. at 23.
\item \textsuperscript{160} Id. at 23–24.
\item \textsuperscript{161} Id. at 24 (“The omission of required information from an annual report is deceptive when it leads investors to the erroneous conclusion that material omitted facts do not exist.”).
\item \textsuperscript{162} Id. (citing Donald C. Langevoort & G. Mitu Gulati, The Muddled Duty to Disclose Under Rule 10b-5, 57 VAND. L. REV. 1639, 1680 (2004) (suggesting that “deliberate omissions” have the “potential to mislead”)).
\item \textsuperscript{163} Id. at 25–26.
\end{itemize}
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not disclosed, “a reasonable investor would assume that no unidentified trends or uncertainties exist.” If an issuer is in fact aware of uncertainties that would be material and chooses to omit it from the MD&A, as required by Item 303, then “its deliberate omission of that required information is deceptive” and this “falls within [section] 10(b)’s prohibition of any ‘deceptive device or contrivance.’”

Respondent then proceeded to analyze the deliberate omission in the context of Rule 10b-5 and found that it satisfied each of Rule 10b-5’s prongs.

Second, Respondent asserted that companies have no such right to deceive investors by omitting information. Respondent challenged Petitioner’s characterization of “pure omissions[,]” since Petitioner rebutted its own argument by filing a report designated to comply with the SEC’s regulations. Petitioner, in 2011, filed as a “risk factor” that future prospects would suffer by relying on government contracts, and later, for this suit, omitted the fact for CityTime having a similar effect. Respondent plainly stated “[t]hat is deception, not ‘pure omission.’” Respondent further assessed Petitioner’s argument that the Court’s previous “fiduciary-type duty” cases never involved issuers and stated simply that in those cases, the defendants were strangers to the issuers and as such, “generally had no obligations to disclose information to investors.” Those cases relied on finding a duty of trust and confidence, which later triggered a duty to disclose or

\[164\] Id. at 26.

\[165\] Id.

\[166\] Id. at 27–29 (The court proceeds to analyze the remaining elements of a 10b-5 action. First, the omission would satisfy the materiality prong because a reasonable investor would want to know about that decision (most of the time for securities cases, it’s understood that a material fact is any fact that would affect a reasonably prudent investor) because the omission would be one of many material facts. Next, coupled with the scienter to withhold that information, it would satisfy the statute’s requirement that the disclosure omits information that would constitute “both a ‘device, scheme, or artifice to defraud’ and an ‘act, practice, or course of business’ that ‘operates ... as a fraud or deceit.’” (citing 17 C.F.R. § 240.10b-5(a), (c))).

\[167\] Id. at 30.

\[168\] Id. at 31.

\[169\] Id. (emphasis added).

\[170\] Id.

\[171\] Id. at 32.
abstain from trading. Respondent distinguished typical duties as just described from issuers’ duties by the fact that issuers “are the object of the 1934 Act’s disclosure regime.” As such, it could not be within Congress’s intent when it passed the statute to carve out an exception for issuers when the facial purpose of the 1934 Act was to, in effect, prevent issuers from deceiving through nondisclosure.

Respondent’s final contention, that omissions constitute deception, was that the PSLRA does not limit the scope of deception as Petitioner would have the court believe, since “Petitioner misread the statute.” The provision that Petitioner cited (15 U.S.C. § 78u-4(b)(1)) applies only to certain private actions, but “[t]hat provision contains no language suggesting an intent to cover all possible theories of private liability.” A private plaintiff can satisfy the law’s provision by specifying the statements that were misleading and why omitting that information was misleading. The fact that a material fact was omitted is not sufficient for a plaintiff to recover since a plaintiff must also prove deception. “[M]eaning that the failure to disclose required information was misleading under the circumstances.” Plaintiffs must further prove materiality, reliance, scienter, loss causation, and finally, damages; by proving all of the necessary elements, then, plaintiffs can enforce section 10(b)’s and Rule 10b-5’s “prohibition on deception and fraud, not Regulation S-K.”

The Respondent’s second argument on appeal was that enforcing liability through deceptive omissions advances Congress’s intent because permitting the Petitioner’s argument would in fact undermine the SEC’s ability to deter future fraudulent conduct.

172 Id.
173 Id. (citing 15 U.S.C. § 78m(a)(2) (“[e]very issuer ... reports’ as the Commission requires[,]”)).
174 Id.
175 Id. at 39.
177 Brief for Respondent, supra note 147, at 40.
178 Id.
179 Id. at 44–45.
180 Id. at 45.
181 Id. (emphasis added).
182 Id.
Finally, Respondent argued that the federal courts possess the judicial economy to handle the fraud claims that may come as a result of ruling in its favor. Respondent noted that Petitioner’s policy arguments do not sufficiently frame the legislative purpose. Congress, in passing the 1934 Act, had a clear intention and it “serves the ‘fundamental purpose’ of implementing ‘a philosophy of full disclosure.’” Respondent asserted that Petitioner’s argument would “undoubtedly strip the Commission of power to police the type of fraud at issue here.” The “falsity” element of proving fraud would effectively render the Commission’s job difficult since it had previously used Item 303 as a basis for liability.

IV. LIKELY SUPREME COURT HOLDING AND ANALYSIS

This Part presents a potential holding for *Leidos* had the Supreme Court ruled on the merits. Before reaching such conclusions, this Part will address existing scholarly works on Item 303 as well as *Leidos* generally. The considerations examined in the works will aid in formulating a likely holding.

A. Articles Relating to the *Leidos* Argument

There are scholars, like Matthew Turk and Karen Woody, who truly believe that there was not, in fact, a circuit split, rendering *Leidos* as an illusory securities law obscurity. They even believe that aside from the Second Circuit declaring that there was a circuit split, the Second and Ninth Circuits are actually in “full agreement.” Turk and Woody find that the actual reasoning between the circuit split rests on two misunderstandings: first, that a duty to disclose, in and of itself, “does not establish a set of conditions that may ‘trigger’” disclosures under Item 303

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183 Id.
184 Id.
185 Id. (quoting Kokesh v. SEC, 137 S. Ct. 1635, 1640 n.1 (2017)).
186 Id. at 46.
187 Id. at 46–47.
189 Id. at 962.
and Rule 10b-5;\textsuperscript{190} and second, that the duty that \textit{Leidos} might address matters only in the insider trading context, rendering it less than ground-breaking.\textsuperscript{191} Referencing judicial “analytical gymnastics,” the authors find that Item 303 omissions could give rise to liability.\textsuperscript{192} However, liability would only extend “provided that the Basic standard of materiality is met.”\textsuperscript{193} Further, the authors bolster their propositions by observing that regulations in the securities industry have “developed in an extremely fragmented and piecemeal fashion” since the founding of the United States’ securities laws.\textsuperscript{194} Similarly, the authors note that cases like this, i.e., an evaluation of duties and disclosure requirements, tend to illustrate how opinions are formed and construed.\textsuperscript{195} Simply put, the authors found that there was no disparity to resolve because courts were just conflating two different standards.\textsuperscript{196} The authors find that a failure to comply with Item 303 could offer actionable fraud claims, but not necessarily in every case.\textsuperscript{197} Finally, the article did leave the idea that \textit{Leidos} will, one day, insist that “the Court ... confront an intractable disagreement over how much disclosure firms are required to provide to investors under federal law.”\textsuperscript{198} The authors believe such questions can be answered with a proper understanding of the securities disclosure regime requirements.\textsuperscript{199}

The authors were correct that the Court would need to answer this question of whether omissions are viable actions under Regulation S-K and when the Supreme Court granted certiorari, they thought so too.\textsuperscript{200} But the authors are underwhelming in how they classify the split. It is not a mere difference of standards or

\textsuperscript{190} \textit{Id.} at 967. \\
\textsuperscript{191} \textit{Id.} \\
\textsuperscript{192} \textit{Id.} at 1010. \\
\textsuperscript{193} \textit{Id.} \\
\textsuperscript{194} \textit{Id.} \\
\textsuperscript{195} \textit{Id.} at 1012 (“What stands out in those opinions, however, is how consistently they converge on a common strategy, which is to seize upon any available distinction that allows the legal materials to be examined as narrowly as possible.”). \\
\textsuperscript{196} \textit{Id.} at 991. \\
\textsuperscript{197} \textit{Id.} at 959, 991. \\
\textsuperscript{198} \textit{Id.} at 1033. \\
\textsuperscript{199} \textit{Id.} at 1034. \\
approaches. Unique to the securities laws, compared to other laws, is the fact that securities laws are built on both statutory and common-law grounds. Because of this, as the authors refer to “fragmented” is more reason for the Supreme Court to answer disparities.\(^{201}\) Additionally, the authors grounded their analysis on the notion that because these are in the insider trading context of the securities laws, that the analysis would not necessarily apply for widespread disclosure duties.\(^{202}\) Again, this analysis seems underinformed to the extent that the securities laws have a great deal of overlap both in doctrine and in application. Sources of the laws as mentioned are versed and because of this, they can be applied in the insider trading context, private fraud actions, SEC 10b-5 actions, in the criminal context with the appropriate culpability, and so forth. So, it does not follow that because these cases and facts under the split are perhaps different that the Supreme Court should not answer the question as a matter of certainty for litigants.

\textbf{B. The Likely Holding}

With the circuit split, the various academic takes on the outcome, and the parties’ arguments before the Supreme Court, it leaves the momentous time for how the Supreme Court would actually rule in this matter uncertain. Simply recapping, the Supreme Court has a few options before it to choose. The Second Circuit suggests that material omissions can give rise to liability.\(^{203}\) The Ninth Circuit purports that Item 303 does not create a duty to disclose otherwise omitted information.\(^{204}\) The Third Circuit, favoring a “cousin” to the Ninth Circuit’s holding, does not totally preclude liability since an omission “does not lead inevitably to the conclusion” that a disclosure would be required.\(^{205}\) With these three options, the circuit split, how would the Supreme Court of the United States rule?

If this question was easily answerable, not only would time and money be saved, but years of litigation would be avoided. The difficulty in this question lies not only in how the Supreme

\(^{201}\) Turk & Woody, \textit{supra} note 188, at 1010.

\(^{202}\) Id. at 1028–29.

\(^{203}\) Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 102 (2d Cir. 2015).

\(^{204}\) \textit{In re NVIDIA Corp. Sec. Litig.}, 768 F.3d 1046, 1055 (9th Cir. 2014).

\(^{205}\) Oran v. Stafford, 226 F.3d 275, 288 (3d Cir. 2000).
Court would hold, but also the approach and rationale to get there. Law school demonstrates the breadth of holdings and the disparity of how and when Justices act when they do. So, it is worth mentioning the many ways the Court could approach the case.

Second, the Supreme Court could use tools and theories of statutory interpretation to ascertain the promulgated regulation’s meaning. Here, the Court would evaluate the ordinary meaning of the text, look at dictionaries, legislative history, and understand the underpinnings of the regulation. The Court would have its clerks go through the comments submitted before promulgation to ascertain a specific intent behind the statute.

Third, and perhaps finally, the Court would take a practical approach to the question. Arguably, the Court will evaluate the repercussions of a holding one way or the other. Justices may rely on their own notions of what the law should be or how Congress likely wished it to be carried out, square it with practicalities, and then reach a decision.

There is reason to believe, and for sake of this Note, to rely on the submitted briefs from the parties (and included herein). This may tie to the practical effects just described. But at the core of this matter is litigation exposure. The two ends, really between the Second and Ninth Circuits, are ones of liability. Regulation S-K will either expose individuals to sweeping liability through material omissions, or else it will continue to create liability through affirmatively misleading statements. Given the current composition of the Supreme Court (and all other matters equal: agency deference afforded under Administrative Law, Statutory Interpretation, Federal Courts, and topics beyond the scope of this Note), the Supreme Court would likely rule on the side of the Ninth Circuit.

While the Second Circuit is termed the Mother Court and while there is reason to construe the securities laws liberally, what is perhaps most telling is that the SEC promulgated Regulation S-K. The SEC, the chief agency tasked with the securities laws, would know whether they wanted to expand liability and simply could have said so. Further, the Regulation pertains to management discussion and analysis by definition. The broad purpose of this is to discuss the on-goings of the company. While this Note does not discuss safe harbor provisions for companies, it seems counterintuitive to hold that omissions (mindful that they must

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be material ones) could give rise to liability when the analysis is tasked with discussing the current status. Simply, if the section deals with disclosure, the Court may be less suspect to omissions. Finally, as fleshed out in Part V below, there would be disparate effects if the Supreme Court held in favor of the Second Circuit.

V. IMPACT LEIDOS COULD HAVE HAD AND SIGNIFICANCE IN THE SECURITIES REGIME

This Part intends to develop the implications that *Leidos* could have had. Whether the Supreme Court ruled in favor of creating an additional actionable duty under Item 303 or found that no such duty was formed, there surely would be implications. This Part will first analyze if the ruling would have any sort of chilling effect when it comes to disclosures generally. It will assess whether affirmative statements or omissions can create more (or perhaps fewer) opportunities for litigation. Subsequently, this Part will ascertain whether permitting Section 10(b) suits could aid in better market pricing on shares’ fundamental value. Since this is an age consistently concerned with litigation strategy and cost analysis, this Part will then develop arguments for plaintiff decision-making. Finally, this Part will explore risk allocation generally in reference to stock price accuracy and individual assessment.

First, there would likely be a chilling effect should Item 303 omissions become actionable. By Item 303’s requirements, management already exposes itself through affirmative statements where investors could argue materiality and reliance. While companies and management are given a safe harbor period (beyond the scope of this Note), assume companies and management are not protected by them; investors literally are permitted to bring suit on those affirmative statements. If the Court ruled that omissions are permissible to bring causes of action via the materiality element, this would undoubtedly dissuade management from stating even affirmative statements. Implicitly, the average investor will assume “if management is not revealing, then they must be concealing.” Management’s forward-looking statements will be devoid of details, of insight, and even harm innovation. Companies might fear that trying new products or inventing new methods will spark litigation. And with this, by *not disclosing*, these companies

207 Id. § 229.303.
will “clam up” and actually inhibit growth, something surely the markets would not appreciate.

For litigation’s sake, it is likely to believe that omissions will give rise to more causes of action. While settlements can always occur, its concerning to think that by virtue of management’s discussion of the current affairs of a company, that an investor, weary of “missing information” or information that is not discussed, but material, does not fare well practically. In a regime that is highly regulated, it is quite uncomfortable for management to be held accountable for what they do not say. The reason for this is simply that to be accountable for the world of possibilities that one could say but does not say should not impose liability to broadly state every fact in the alternative. For example, imagine a MD&A where a company wants to announce the possibility of a merger. It could say “we are now planning a merger with Company A.” If a suit was brought because management did not say that it was 100% certain, then the company’s language would change. Perhaps something like “we are now planning a merger with Company A, but there is always a possibility that the merger will fall through because the markets are uncertain, and we wish to disclose the possibility that it is not definite.” Notice how the language is not only lengthier, but it is also vaguer. But even under a regime where a company could be liable, an investor still could bring a suit on what management failed to say in even a broad disclosure.

Instead, intuitively, it makes more sense, as the law currently stands, to hold them accountable for what they do say. Omissions are challenging because, by definition, it is unclear what it includes. Will management have to include all possible and foreseeable harm? Will they have to release potential product designs that competitors can then get a hold of and then compete at lower costs? There are arguably more questions than answers in this world where an omission-basis cause of action is adopted. And it seems more likely than not that the Supreme Court would err on the side of caution and leave this as a matter of agency deference.208

Second, management wants to comply with the federal securities laws. Not only are there threats of criminal sanctions through wanton or intentional illegal acts, but the civil sanctions harm a firm’s reputation, culture, and can inhibit the firm’s fundamental

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value. Commonly referred to as the inherent or true value of a share of a company, the fundamental value drives firm behavior, among other things. Scholars in the securities industry have concerned themselves greatly with what determines the fundamental value or even if it’s even calculable. While this Note does not address these particularly, there is reason to believe that exposure to litigation will, in some ways, harm the value of a firm. Shareholders, those who would purportedly bring these private causes of action, are actually harmed by way of litigating these omissions. It harms the firm’s value and really, their own bottom line.

Finally, and perhaps most obviously, Regulation S-K and Item 303 are promulgated by the SEC by way of its rule-making power prescribed by Congress. As a matter of practice and even law, it is probably in the best interest of the SEC to ascertain and then promulgate whether Item 303 encapsulates omissions as material for a cause of action. While the judiciary has ruled by common law some aspects of the securities industry, it is a highly regulated and reviewed industry by the SEC. The regulation is devoid of any reference to omissions and it is not clear why deference should not be afforded to the agency in situations precisely as this.

**CONCLUSION**

The securities field is nothing short of complex, intricate, and ever-changing. The disclosure regime and litigation tactics become even more cumbersome when trying to construe proscriptive statutes while simultaneously trying to allocate risk or identify cost structures in order to meet disclosure requirements. All in all, the securities industry presents challenges today and really, every day.

*Leidos* presented a unique opportunity for the Supreme Court to answer a straightforward disclosure question. If the Court answered in the affirmative—that an omission under Item 303 did create an actionable fraud claim—litigation costs surely would rise, the stock prices would be influenced, and disclosures

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210 *See James J. Park, Halliburton and the Integrity of the Public Corporation, 10 DUKE J. CONST. L. & PUB. POL’Y 71, 72 (2015).*

211 *See 17 C.F.R. §§ 229.10, 229.303.*
generally would likely be chilled. On the other hand, answering in the negative—that such a duty does not exist—could promote certainty, allow firms to allocate risk in their disclosures, and allow the market to ascertain which information is valuable. But this case also demonstrates key takeaways: how statutory language can cause a rift in the circuits; how circuits may construe language to create a split; and, perhaps most importantly, how parties frame arguments in order to create, or avoid creating, an entirely new duty to disclose that would be actionable under Section 10(b) and Rule 10b-5.

At the very least, this Note seeks to offer an overview of the securities authorities at play, the creation of a circuit split, the arguments presented by both Petitioner and Respondent, and the likely ruling the Supreme Court would have made. Additionally, if the Supreme Court had ruled, the impact of such a ruling would have been as educational as the ruling itself. The securities disclosure regime needs certainty, and Leidos could have provided just that. Perhaps a few years from now a similar fact pattern will provide the opportunity for the Supreme Court to rule on the merits. For now, the existence of a circuit split presents its own problems, but that is for another note, for another time.

Item 303 and whether an omission from the Management Discussion and Analysis constitutes actionable fraud remains litigation-ready, where attorneys can present their best arguments depending on their circuits. The Second Circuit may be more plaintiff friendly, whereas the Ninth may require additional materiality to be shown. Nevertheless, this Note hopes to provide clarity in the extremely complex world of securities litigation.