Supreme Court debates private right of action, half-truths, and omissions

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In the dispute at the center of *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, the Supreme Court recently heard arguments in a case that could potentially expand the right of private action for shareholders under SEC Rule 10b-5.

The defendant in the original case, Macquarie, owned and operated several infrastructure businesses, the most profitable of which provided bulk liquid storage for a high-sulfur fuel oil known as "No. 6 oil."

In 2016, the International Maritime Organization announced that it would be implementing a new regulation in 2020 (IMO 2020) that would restrict the sulfur content allowed in fuel oil used in shipping. Demand for No. 6 oil and its storage subsequently fell between 2016 and 2017, and Macquarie was forced to cut its quarterly dividend guidance by 31%, dropping its stock price by more than 40%.

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Institutional investor and lead plaintiff Moab Partners, L.P. brought a suit against Macquarie in February 2019 for not informing shareholders of the impending IMO 2020 regulation and its potential effect on the company's finances as part of Item 303 of Regulation S-K.

Regulation S-K lays out the qualitative reporting requirements for public companies when making certain filings with the SEC, and Item 303 specifically consists of Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). The MD&A is meant to include disclosures regarding trends, events, or uncertainties that could reasonably have a material effect on the company's finances or operations. 17 CFR § 229.303

Whereas a violation of Regulation S-K by itself would entail an SEC inquiry and possible enforcement action, Moab brought its suit under Section 10b of the Securities and Exchange Act of 1934 and SEC Rule 10b-5, which allows private parties to sue for instances of securities fraud — a much higher degree of liability with more severe penalties. Rule 10b-5 was created as a "catch-all" fraud provision that makes it unlawful for companies:

> "to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading … in connection with the purchase or sale of any security." 17 CFR § 240.10b-5(b)

Originally, the District Court for the Southern District of New York (SDNY) granted Macquarie's motion to dismiss in September 2021 for Moab's failure to state a claim. On appeal, the 2nd U.S. Circuit Court of Appeals found that Moab had indeed pleaded actionable omissions and vacated the SDNY's dismissal order in December 2022. The Supreme Court ultimately granted a writ of certiorari, and oral arguments took place in January 2024.

The question posed to the Supreme Court was whether the failure to provide a disclosure required under Item 303 can give rise to a private right of action under Section 10b, even without an otherwise misleading statement. In the context of omissions and misleading statements, there is a distinction between the terms "half-truth" and "pure omission."

A "half-truth" is when an affirmative statement on a certain subject is rendered misleading because of omitted information, while a "pure omission" is when a subject matter is simply left out and never commented upon at all. Both parties generally agreed that Rule 10b-5(b) provides for private liability for a half-truth, but not necessarily for a pure omission. The parties disagreed about whether to categorize the omission of the IMO 2020 information as a half-truth or pure omission.

Macquarie maintained that its decision not to mention IMO 2022 to shareholders amounted to a pure omission and was therefore not subject to Section 10b liability. In the oral argument, counsel for the petitioner Linda T. Coberly argued that Moab had failed to identify any specific statements that were rendered misleading by the omission of IMO 2020. She stated that, "The text doesn't permit eliding the statement requirement by treating the entire management narrative as misleading if one thing is left out."

Justice Elena Kagan questioned this, saying, "If you have a set of paragraphs or a set of sentences ... which paints a very rosy picture of the prospects of a company, and then it turns out that you've omitted the thing that is actually going to crater the company next month, that rosy picture seems to be rendered misleading."

Coberly argued that the Private Securities Litigation Reform Act (PSLRA), which governs private securities fraud class actions and sets forth certain pleading requirements, requires that the complainant identify specific, discrete statements made misleading by an omission, that are on the same subject as the omitted fact. Coberly stated that Macquarie was simply asking for the Court to require Moab to point to the misleading, like-kind statement within the MD&A.

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Moab, on the other hand, argued that the entire MD&A narrative constituted the "statement" that was rendered misleading by the IMO 2020 omission. Counsel for the respondent, David C. Frederick, stated, "This case involves a classic 10b-5(b) misleading half-truth. Petitioners disclosed a few known trends that would affect their bottom line but omitted the IMO 2020 uncertainty that would decimate 40 percent of their revenue ... A reasonable investor would expect the description of known trends to be complete and would be misled by such a material omission."

Moab's written brief also claimed that the petitioners had erred in characterizing this case as involving a pure omission. Their stance was that the annual report, the MD&A itself, was the relevant misleading statement in question and the like-kind subject matter was the material trend disclosure requirement of Item 303. In his oral argument, Frederick posited that a pure omission in this case would only occur if a company didn't file an MD&A at all.

Justice Kagan pointed out that this argument seemed to diverge from the question presented before the Court, which dealt with whether an omission could create liability under 10b-5 *even in the absence of* a statement made misleading by that omission. She then re-framed the dispute: "So what everybody is arguing about is just sort of how narrow or how capacious we should understand the requirement that there needs to be another statement that's rendered misleading?"

Frederick confirmed that this was essentially correct and encouraged the Court to clarify definitively that the context of Item 303 (i.e., the required disclosure of material trends) was sufficient enough context for thinking of an MD&A as a statement on a like-kind subject. If thought of in this way, then an omission of a material trend would necessarily render the MD&A a series of half-truths, and thus be potentially actionable under 10b-5.

However, it remains to be seen whether the Court will rule on the original question that was presented to it (*Can a violation under Item 303 give rise to a private right of action under Section 10b, even without an otherwise misleading statement?*) or whether it will answer the slightly different question presented during oral arguments (*How narrow or how capacious should the requirement that there needs to be another statement that's rendered misleading be?).*

If the Court chooses to answer the latter question and does so in favor of Moab, this could theoretically open the floodgates for an entirely new wave of Section 10b private actions stemming from Item 303 disclosures, exposing business managers to a heightened degree of liability. However, as amicus curiae of Moab have pointed out, potential plaintiffs would still need to meet pleading requirements such as scienter and materiality, and businesses would still enjoy certain safe harbor protections related to forward-looking statements.

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About the author

Roger E. Barton is the managing partner of New York City-based **Barton LLP** and a litigator. He represents clients in the capital markets and financial services industries regarding securities fraud, breach of fiduciary duty, common-law fraud, 10b-5 class actions, and breach of representations and warranties. He is a fellow of the Litigation Counsel of America and can be reached at rbarton@bartonesq.com.

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