SUPREME COURT LIMITS SHAREHOLDER SUITS BASED ON "PURE OMISSIONS" IN CORPORATE DISCLOSURES

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US Litigation and Dispute Resolution Alert

On Friday, 12 April 2024, the United States Supreme Court unanimously ruled that a corporation's failure to disclose certain information about its future business risks, without more, cannot form the basis of a private securities fraud claim under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.[1] The ruling resolved a split among the circuits, and vacated a ruling from the Second Circuit, which would have expanded an individual shareholder's private right of action under Section 10(b) for securities fraud.[2]

Macquarie Infrastructure Corporation (Macquarie) is a publicly traded company whose subsidiary stores and handles commodity and specialty chemicals, such as petroleum, biofuels, chemicals, and oil products.[3] In 2016, the United Nations' International Maritime Organization formally adopted IMO 2020, a regulation that, beginning in 2020, capped the sulfur content of fuel oil used in shipping at 0.5%. This impacted Macquarie's storage of No. 6 fuel oil, a byproduct of the refining process that typically has a sulfur content close to 3%.[4] Macquarie discussed IMO 2020 in a publicly facing document in February 2018, at which time it announced that the amount of storage capacity contracted for use by its subsidiary's customers had dropped in part because of the structural decline in the No. 6 fuel oil market.[5] Macquarie's stock price fell approximately 41%.[6]

Investor Moab Partners, L.P. (Moab) sued Macquarie and certain of its officers for securities fraud, alleging, among other things, violations of Section 10(b) and Rule 10b-5.[7] The crux of Moab's argument was that Macquarie's public statements “were false and misleading” because from the time of the rule's adoption in 2016 until February 2018, Macquarie had “concealed from investors that [its subsidiary's] single largest product . . . was No. 6 fuel oil.” In Moab's view, Macquarie had “'a duty to disclose the extent to which [its subsidiary's] storage capacity was devoted to No. 6 fuel oil,” under Item 303 of Securities and Exchange Commission (SEC) Regulation S-K,[8] a regulation that requires a company to disclose “known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact” on the company's financial performance. Moab contended that Macquarie's failure to make this disclosure earlier was a violation of Section 10(b) and Rule 10b-5.

The Southern District of New York dismissed Moab's complaint, concluding that Moab had not “actually plead[ed] an uncertainty that should have been disclosed” or “in what SEC filing or filings Defendants were supposed to disclose it.”[9] The Second Circuit reversed the lower court's decision.[10] The Second Circuit determined that “[c]rediting [Moab's] allegations as true, IMO 2020's significant restriction of No. 6 fuel oil use was known to [Macquarie] and reasonably likely to have material effects on [Macquarie's] financial condition or results of operation.”[11]

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The Second Circuit's decision created a split among the Circuits regarding whether an alleged violation of the duty to disclose under Item 303 can, by itself, support a cause of action under Section 10(b). The Third, Ninth, and Eleventh Circuits have held that a failure to disclose under Item 303 is not sufficient on its own to support a Section10(b) claim, and the Fifth Circuit expressed a similar view in dicta.[12]

The Supreme Court vacated the Second Circuit's decision, holding that "[p]ure omissions are not actionable under Rule 10b-5."[13] In doing so, the Supreme Court distinguished pure omissions from "half-truths:" "the difference between a pure omission and a half-truth is the difference between a child not telling his parents he ate a whole cake and telling them he had dessert."[14] The Supreme Court found that Rule 10b-5, by its plain text, requires identifying affirmative assertions (i.e., "statements made") before determining if other facts are needed to make those statements "not misleading."[15] The Court rejected Moab's argument that a plaintiff does not need to plead any statements rendered misleading by a pure omission on the ground that reasonable investors know that Item 303 requires a company to disclose all known trends and uncertainties. The Court observed that this argument "reads the words 'statements made' out of Rule 10b-5(b) and shifts the focus of that Rule and Section 10(b) from fraud to disclosure."[16]

By explicitly affirming that pure omissions are not actionable under Rule 10b-5, this decision has important implications for securities fraud claims. The decision is a rejection of plaintiffs' attempts to expand the private right of action under Section 10(b) to encompass claims pled upon pure omissions. The decision is also a tempered victory for public companies that are considering their voluntary and required disclosures with respect to ESG matters and the related risk of litigation and claims.

Our lawyers are pleased to discuss how this decision impacts our clients as they consider their own disclosures and the risks that the current litigation landscape may pose to them.

FOOTNOTES

[1] *Macquarie Infrastructure Corp., et al. v. Moab Partners LP, et al*., Case No. 22-1165 (Apr. 12, 2024) (the Opinion).

[2] Section 10(b) of the Securities Exchange Act of 1934 prohibits manipulation and deception in the purchase or sale of securities. Rule 10b-5 makes it unlawful for a company to make an untrue statement or to omit a material fact necessary in order to make statements made not misleading.

[3] Opinion at *2.

[4] *Id.*

[5] *Id.* at *3.

[6] *Id.*

[7] *Id.*

[8] *Id.*

[9] *Id.*

[10] *Moab Partners, L.P. v. Macquarie Infrastructure Corporation*, Case No. 21-2524, 2022 WL 17815767, *1 (2d

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Cir. Dec. 20, 2022) (the Second Circuit Decision).

[11] Opinion at *4 (quoting the Second Circuit Decision at *3).

[12] *See* O*ran v. Stafford*, 226 F.3d 275 (3d Cir. 2000); *In re NVIDIA Corp. Sec. Litig*., 768 F.3d 1046 (9th Cir. 2014); *Carvelli v. Ocwen Fin. Corp*., 934 F.3d 1307 (11th Cir. 2019); *Mun. Emps.' Ret. Sys. of Mich.v. Pier 1 Imps., Inc*., 935 F.3d 424, 436 (5th Cir. 2019).

[13] Opinion at *5, *8.

[14] *Id.* at *5.

[15] *Id.* at *5-6.

[16] *Id.* at *6-7 (citing *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud")).

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