

Supreme Court Holds that Pure Omissions are Not Actionable under Rule 10b-5

by Michael Rowe, Nicholas K. Tygesson, and Jack Huerter

The Supreme Court recently issued a significant decision regarding the reach of SEC Rule 10b-5. In *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, the Court addressed whether the failure to disclose information required by Item 303 of SEC Regulation S-K, which affirmatively requires disclosure of certain known trends and uncertainties, can support a private action under Rule 10b-5 where the alleged omission does not render any statements made misleading. In a unanimous opinion authored by Justice Sotomayor, the Court answered that question with a resounding “no,” holding that “pure omissions are not actionable under Rule 10b-5.” Rather, a Rule 10b-5 claim must always be based on a statement that is itself false or misleading or rendered misleading by omission.

The case arose from the alleged failure of defendant Macquarie to disclose the potential harm that a United Nation’s International Maritime Organization regulation, IMO 2020, could have on its business. Macquarie owns a subsidiary that operates large bulk liquid storage terminals for liquid commodities, including a fuel oil with a typical sulfur content of 3%. The UN regulation, adopted in 2016, capped the sulfur content of fuel oil used in shipping at 0.5% by 2020, which significantly limited the marketability of the fuel oil and the need for its storage. In the years that followed, the company did not discuss IMO 2020 in its public filings. In February 2018, the company announced during an earnings call that it had missed its projections and experienced a decline in the amount of storage contracted for at its subsidiary, including as a result of the decline in the fuel oil market. The company’s stock price dropped by 41%.

Following the stock drop, investors filed suit in the Southern District of New York asserting a Rule 10b-5 claim for securities fraud. The suit included a claim that Macquarie had omitted information it had a duty to disclose under Item 303, which requires disclosure of “any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.” 17 C.F.R. § 229.303(b)(2)(ii). On appeal from the District Court’s dismissal, the Second Circuit reversed, holding that a violation of

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Item 303, which the plaintiff had adequately alleged, could form the basis of a Rule 10b-5 claim—which, while consistent with Second Circuit precedent, was in conflict with decisions from other circuits.

In a succinct opinion that hewed closely to the regulation’s text, the Court rejected the Second Circuit’s approach and held that Rule 10b-5 “does not proscribe pure omissions” even where a statute or regulation creates an affirmative duty to disclose. Implementing Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 makes it unlawful 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.” 17 C.F.R. §240.10b-5(b) (emphasis added). Placing great weight on the use of the phrase “statements made,” the Court concluded that the rule only requires disclosure of “information necessary to ensure that statements already made are clear and complete,” i.e., to avoid misleading half-truths, and thus does not extend to pure omissions. Even though a reasonable investor would know that Item 303 requires disclosure of all known trends and uncertainties, and thus failure to disclose such an item would lead (or mislead) investors into believing that there were no such trends or uncertainties, Rule 10b-5’s focus on specific statements governs its application.

The Court then contrasted the text of Rule 10b-5 with that of Section 11 of the Securities Act of 1933. In Section 11(a), Congress imposed liability for a registration statement that “contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading.” 15 U. S. C. §77k(a). Unlike Rule 10b-5, the plain language of Section 11(a) expressly and separately proscribes untrue statements, pure omissions, *and* misleading half-truths—which the Court found “telling.”

The Court also addressed the oft-quoted maxim from *Basic Inc. v. Levinson*, 485 U. S. 224, 239, n. 17 (1988), that “[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5.” The Second Circuit had in fact previously cited that passage to support its rule that silence, in the presence of a duty to disclose, can form the basis of a Rule 10b-5 claim. See, e.g., *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 101 (2d Cir. 2015); *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993). In *Macquarie*, the Court elaborated on it, noting that “[e]ven a duty to disclose, however, does not automatically render silence misleading under Rule 10b-5(b).”

The Court’s decision is undoubtedly a positive development for defendants in private securities litigation. Pure-omissions theories, whether reliant on Item 303 or another statute or regulation, are no longer viable in Rule 10b-5 cases. Moreover, *Macquarie* calls into question cases permitting pure-omission claims in other areas of the securities law, e.g., in cases brought under Section 12(a)(2) or Rule 14a-9, where the relevant language likewise focuses on the statements made.

That said, as the opinion itself makes clear, the Court’s ruling has its limits. Most notably, omissions are still actionable under Rule 10b-5 if the omitted fact was necessary to avoid creating a misleading half-truth. In fact, the plaintiff’s counsel in *Macquarie* itself,

following the Supreme Court's opinion, has been quoted as saying "[t]here is going to be no impact on our case, because the Supreme Court has given us a road map to plead a half-truth, which we have." Expect plaintiffs' counsel in other securities fraud actions to make increasing use of misleading half-truth theories—already commonplace—to avoid the Court's *Macquarie* ruling. In addition, the Court emphasized that the SEC still has the authority to investigate and prosecute violations of its regulations, including Item 303, and that pure-omission theories are still viable under Section 11(a).