

U.S. Supreme Court Agrees To Hear Securities Fraud Omissions Case

The U.S. Supreme Court will resolve a critical question governing the scope of liability in securities fraud cases which has split the circuit courts to date. The case, *Leidos Inc. v. Indiana Public Retirement System*, No. 16-581, is a securities class action alleging violation of Section 10(b) of the Securities Exchange Act of 1934 (the “Exchange Act”) and SEC Rule 10b–5 thereunder. The Petition for Writ of Certiorari (the “Petition”) presents the following question for review: “Whether 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 [regarding management disclosures] creates a duty to disclose that is actionable under Section 10(b) . . . and Rule 10b–5.”

In framing this issue for decision, Petitioner-Defendant restated the well-established principle that under Section 10(b), an “omission may be fraudulent only if the omitted information is necessary to make an affirmative statement ‘not misleading.’” Thus, ‘companies can control what they have to disclose . . . by controlling what they say to the market.’” Petition at i (quoting *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 45 (2011)). The Second Circuit’s decision in this case is a sharp departure from this rule since it would make an omission under Item 303 actionable, according to Petitioner.

The action brought by Indiana Public Retirement System and others alleged that Leidos, Inc., formerly known as SAIC, Inc., and various officers and directors, violated Sections 10(b) and 20(a) of the Exchange Act. The complaint centers on a 2001 prime contract between SAIC and the City of New York known as “City Time.” The project called for SAIC to develop and implement an automated time, attendance, and workforce management solution for various city agencies.

In carrying out the City Time project, two SAIC employees and certain subcontractors engaged in a kickback scheme in which the SAIC employees received a series of illicit payments. The accomplices took detailed steps to avoid detection, including laundering the ill-gotten funds through international bank accounts. Notwithstanding these efforts, the scheme was eventually discovered and the participants were prosecuted. SAIC

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publically offered to repay the City and entered into a deferred prosecution agreement with the U.S. Attorney's Office, paying over \$500 million in fines and forfeitures. The firm accepted responsibility for the conduct of its employees.

The class action alleged that SAIC made certain false statements and omissions in its filings with the SEC regarding the City Time project. The firm's March 25, 2011 Form 10-K, for example, did not comply with Generally Accepted Accounting Principles ("GAAP") and omitted disclosures in this regard governed by Item 303, according to the complaint. That Item requires the "Management's Discussion & Analysis" ("MD&A") section of a filing to include a description of any known trends or uncertainties that might have a material impact on net sales, revenues, or income from continuing operations. 17 C.F.R. § 229.303(a).

The District Court in this action dismissed the complaint for failing to state a claim and not meeting the heightened pleading standards imposed by the Private Securities Litigation Reform Act ("PSLRA"). The Second Circuit reversed, relying on its earlier decision in *Stratte v. McClure v. Morgan Stanley* which held that omitting statements from the MD&A required by Item 303 "is indeed an omission that can serve the basis for a Section 10(b) securities fraud claim." 776 F.3d 94, 100 (2d. Cir. 2015). In *Stratte*, the Second Circuit expressly acknowledged that its "conclusion is at odds with the Ninth Circuit's recent opinion in *In re NVIDIA Corp. Securities Litigation*, 768 F.3d 1046 (9th Cir. 2014)." *Id.* at 103.

The case has significant ramifications for issuers when preparing filings that require an MD&A section. The Second Circuit's cases could lead to an increase in securities fraud claims, chipping away at the PSLRA and effectively creating a mechanism by which plaintiffs can bring private rights of action under Item 303, according to Petitioner. This risk is accentuated by the type of information required in the MD&A under Item 303. Some commentators claim that the broad, open-ended disclosures suggested by the provision regarding possible trends or uncertainties may excessively expand potential liability in securities class actions and encourage unnecessary suits. The case will be heard by the Court next term.

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