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Brief of Professors at Law and Business Schools as Amicus Curiae in Support of Respondents

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No. 16-581

In The
Supreme Court of the United States

LEIDOS, INC., fka SAIC, INC.,

Petitioner,

v.

INDIANA PUBLIC RETIREMENT SYSTEM, INDIANA STATE TEACHERS' RETIREMENT FUND, AND INDIANA PUBLIC EMPLOYEES' RETIREMENT FUND,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

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BRIEF OF PROFESSORS AT LAW AND BUSINESS SCHOOLS AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether the Second Circuit correctly held that the disclosure of the information required in an annual report on Form 10-K by 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 Rule 10b-5 thereunder.

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iv
INTEREST OF *AMICI CURIAE*	1
SUMMARY OF ARGUMENT	2
ARGUMENT	6
A. The Requirement that Companies Provide Disclosure under the Periodic Reporting Process Creates a Duty to Disclose Under the Antifraud Provisions	8
B. The Reaffirmation of a Duty to Disclose with Respect to Required Disclosure Will Not Result in "Massive Liability" or Efforts to Enforce Technical Violations of the Periodic Reporting Requirements	17
C. Eliminating Fraud Actions for Nondisclosure of Information Required by Item 303 and other Provisions of Regulation S-K Will Impair the Quality of the System of Periodic Reporting	22
1. Existing Levels of Enforcement Have Not Resulted in Adequate Levels of Compliance with Item 303 of Regulation S-K	22
2. The Failure to Find a Duty to Disclose Will Significantly Reduce Enforcement of the Periodic Reporting Requirements and the Deterrence of Noncompliance	27
CONCLUSION	32

TABLE OF CONTENTS – Continued

Page

APPENDIX

Amici Curiae .... App. 1

TABLE OF AUTHORITIES

Page

CASES

A.D. Transp. Inc. v. Mich. Materials & Aggregates Co., Nos. 290236, 290250 (Mich. Ct. App. Sept. 30, 2010) 15

Bienewski Ltd. P'ship v. Tising, 63 F.R.D. 360 (E.D. Wis. 1974) 3, 28

Binette v. Dyer Library Ass'n, 688 A.2d 898 (Me. 1996) 14

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TABLE OF AUTHORITIES – Continued

Page

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In re Cypress Bioscience Inc., Exchange Act Release No. 37,701, 1996 WL 531656 (admin. proc. Sept. 19, 1996) 12

In re DeGeorge Fin. Corp., Exchange Act Release No. 39,319, 1997 WL 700691 (admin. proc. Nov. 12, 1997) 12

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TABLE OF AUTHORITIES – Continued

Page

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Peek v. Gurney [1873] LR 6 (HL) 377 13

Rodopoulos v. Sam Piki Enters', Inc., 570 So. 2d 661 (Ala. 1990) 13

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S.E.C. v. Monterosso, 756 F.3d 1236 (11th Cir. 2014) 3, 28

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TABLE OF AUTHORITIES – Continued

Page

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STATUTES

15 U.S.C. § 77g....10

15 U.S.C. § 77k(a)....10

15 U.S.C. § 77l(b)....10

15 U.S.C. § 78m(a)....6

15 U.S.C. § 78m(j)....7

15 U.S.C. § 78r....28

15 U.S.C. § 78u-4....20

15 U.S.C. § 78u-5(b)(1)....30

15 U.S.C. § 78u(d)(2)....29

18 U.S.C. § 1350....16

Delaware General Corporation Law § 220....23

Private Securities Litigation Reform Act of 1995....10

REVISED UNIFORM SECURITIES ACT § 501....29

Sarbanes-Oxley Act of 2002
- Section 302....34
- Section 401....7
- Section 906....34

TABLE OF AUTHORITIES – Continued

Page

Securities Act of 1933
Section 11 .... *passim*
Section 12 10
Section 12(a)(2) 3, 10, 18, 21, 32
Section 12(b)..10
Section 17(a)(1) 3, 28
Section 17(a)(2) 29
Section 17(a)(3) 3, 28

Securities Exchange Act of 1934
Section 10(b)... *passim*
Section 13(a)... 5, 6, 12, 31
Section 18 28

Pub. L. No. 104-67, 109 Stat. 737 (1995)...................10

RULES AND REGULATIONS

17 C.F.R. § 229.10, et seq. 6
17 C.F.R. § 229.303 .... *passim*
17 C.F.R. § 229.303(a)(1)...7
17 C.F.R. § 229.303(a)(2)(ii)..7
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17 C.F.R. § 229.303(a)(4)...7
17 C.F.R. § 229.303(a)(4)(i)(D) 7
17 C.F.R. § 229.402 23
17 C.F.R. § 229.404 23

TABLE OF AUTHORITIES – Continued

Page

17 C.F.R. § 229.601(b)(31)..16

17 C.F.R. § 230.506(d)(1)(v) 30

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17 C.F.R. § 240.10b-5(b).....................................*passim*

17 C.F.R. § 240.10b-5(c) 2, 3, 28

17 C.F.R. § 240.13a-11(c) 13

17 C.F.R. § 240.13a-14(a)..16

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17 C.F.R. § 243.102 ....12, 31

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Page

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Page

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Page

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Page

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TABLE OF AUTHORITIES – Continued

Page

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TABLE OF AUTHORITIES – Continued

Page

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TABLE OF AUTHORITIES – Continued

Page

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INTEREST OF *AMICI CURIAE*[1]

Amici are scholars at law and business schools in the United States and Canada whose research and teaching focus on federal securities regulation and the governance of public corporations.[2] The authors appearing as counsel on this brief have together submitted to this Court briefs on prior occasions as *amici* in cases arising under the federal securities laws on behalf of law and business faculty.[3] All four authors have written about the effect of Section 10(b) on the disclosure requirements adopted by the Securities and Exchange Commission.[4]

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[1] This brief was not authored, in whole or in part, by counsel for either party, and no person other than *amici* and their academic institutions contributed monetarily to the preparation or submission of this brief. None of the schools that employ *amici* are a signatory to this brief, and the views expressed here are not affiliated with those institutions. This *amicus* brief is filed pursuant to the blanket consent executed by both parties and filed with this Court (by Respondents and Petitioner on June 20, 2017).

[2] A list of *amici* is attached as an appendix.

[3] The authors on this brief have appeared as counsel in some or all of the following briefs filed as *amicus* on behalf of law and business faculty. *See* Brief for Faculty at Law and Business Schools as Amici Curiae Supporting Respondents, *Merck & Co. v. Reynolds*, 559 U.S. 633 (2009) (No. 08-905); Brief for Professors at Law and Business Schools as Amicus Curiae Supporting Respondents, *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27 (2010) (No. 09-1156); Brief for Professors at Law and Business Schools as Amici Curiae Supporting Respondents, *Omnicare Inc. v. Laborers District Council Construction Industry Pension Fund, et al.*, ___ U.S. ___, 135 S. Ct. 1318 (2015).

[4] J. Robert Brown, Jr., The Regulation of Corporate Disclosure (4th ed. 2016) (chapters on duty to disclose, materiality, MD&A); James D. Cox et al., Securities Regulation: Cases and

Amici have a common interest in ensuring a proper interpretation of the statutory framework put in place by Congress. While all participating *amici* may not agree with every statement in the brief, all *amici* agree that Item 303 of Regulation S-K creates a duty to disclose for purposes of Rule 10b-5(b). As far as the authors of this brief are aware, *amici* have no financial stake in the outcome of this litigation.

SUMMARY OF ARGUMENT

This case addresses a narrow and, until now, largely uncontroversial issue; whether the omission of information required to be disclosed in a periodic report filed with the Securities and Exchange Commission ("SEC" or "Commission") gives rise to a duty to disclose under Section 10(b) and Rule 10b-5(b) under the Securities Exchange Act of 1934 ("Exchange Act").[5]

MATERIALS (8th ed. 2017); Joan MacLeod Heminway, *Personal Facts About Executive Officers: A Proposal for Tailored Disclosures to Encourage Reasonable Investor Behavior*, 42 WAKE FOREST L. REV. 749, 754-59 (2007) (describing the application of various disclosure rules under the federal securities laws relating to private facts about public company executives); Lyman P.Q. Johnson, *Securities Fraud and the Mirage of Repose*, 1992 WIS. L. REV. 607 (1992).

[5] We note that a duty to disclose is an element of a fraud claim under subsection (b) of Rule 10b-5. 17 C.F.R. § 240.10b-5(b) (2017). Subsection (a), however, permits actions for a "device, scheme, or artifice to defraud" and subsection (c) for "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person. . . ." § 240.10b-5(a); § 240.10b-5(c). The Rule encompasses "conduct." *See Stoneridge Inv. Partners LLC v.*

The court below answered this in the affirmative and we agree. The decision is consistent with the plain meaning of the rule, the longstanding position of the Commission, and the common law and is important to maintain adequate compliance with the mandatory disclosure requirements embodied in the system of periodic reporting.

This Court's affirmation of a duty to disclose will have little effect on existing practice. Under the current state of the law, investors can and do bring fraud claims for nondisclosure of required information by public companies. Only one circuit has foreclosed these claims and only for disclosure required under Rule 10b-5(b). Even in that circuit, however, investors can continue to bring such claims under Section 11 and 12(a)(2) of the Securities Act of 1933 ("1933 Act"). Moreover, issuers are aware, and regularly counseled, that Item 303 of Regulation S-K ("Item 303") creates a duty to disclose. 17 C.F.R. § 229.303. Thus, affirming the existence of such a duty to disclose will not significantly alter existing practices nor create a new avenue for litigants that will lead to "massive liability" or

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Scientific-Atlanta, Inc., 552 U.S. 148, 158 (2008) ("Conduct itself can be deceptive. . . ."). The deliberate decision to withhold information required in a periodic report could constitute conduct actionable under subsection (a) and (c) even absent the existence of a duty to disclose for purposes of subsection (b). *See S.E.C. v. Monterosso*, 756 F.3d 1236, 1334 (11th Cir. 2014) (Section 17(a)(1) or (3) of the 1933 Act and Rule 10b-5(a) & (c) applied to persons who engaged in "deceptive acts as part of a scheme to generate fictitious revenue"); *see also Bienewski Ltd. P'ship v. Tising*, 63 F.R.D. 360, 365 (E.D. Wis. 1974) (noting that "even silence or omission can be a sufficient contribution to a scheme to defraud").

widespread enforcement of "technical reporting violations."

At the same time, the failure to find a duty to disclose in these circumstances will hinder enforcement of the system of mandatory reporting applicable to public companies and weaken compliance. Inadequate compliance can already be seen with respect to the disclosure required in management's discussion and analysis of financial condition and results of operations ("MD&A") under Item 303, the provision at issue in this case. MD&A disclosure remains inadequate. One SEC official characterized the level of information as "too much elevator music" and not enough "useful analysis." This lament has persisted despite the presence of private actions by investors and the application of substantial effort and deployment of significant resources by the Commission. Any reduction in the existing level of, or the tools available for, enforcement, whether public or private, will make efforts to ensure adequate compliance with Item 303 even more difficult.

Reversal of the lower court will reduce incentives to comply with the requirements mandated by the system of periodic reporting. Enforcement under Section 10(b) and Rule 10b-5(b) by investors in the case of nondisclosure will effectively be eliminated. The interpretation will likewise reduce the tools available to the Commission to ensure compliance with the system of periodic reporting. In an environment of diminished enforcement, reporting companies could perceive their

disclosure obligations less as a mandate than as a series of options. Required disclosure would more often become a matter of strategy, with issuers weighing the obligation to disclose against the likelihood of detection and the reduced risk of enforcement.

Under the approach, investors would not make investment decisions on the basis of "true and accurate corporate reporting. . . ." They would operate under the "predictable inference" that reports included the disclosure mandated by the rules and regulations of the SEC. Particularly where officers certified the accuracy and completeness of the information provided in the reports, investors would have an explicit basis for the assumption. They would therefore believe that omitted transactions, uncertainties, and trends otherwise required to be disclosed had not occurred or did not exist. Trust in the integrity of the public disclosure system would decline.

In this case, investors have alleged that Petitioner omitted to disclose a material uncertainty that, at the time disclosure decisions were being made, was "known" to management and that management understood would be "reasonably" expected to have a material impact on Petitioner. The record contains officer certifications providing that the annual report on Form 10-K filed by the Petitioner and at issue in this case, among other things, complied with the requirements of Section 13(a) of the Exchange Act. The lower court correctly recognized that the mandatory disclosure requirements contained in Item 303 gave rise to a duty to disclose and that the omission of material trends

and uncertainties could mislead investors. The decision below should be affirmed.

ARGUMENT

Section 13(a) of the Exchange Act assigned to the Commission the authority to put in place the system of reporting by public companies in order to facilitate trading in the secondary markets. 15 U.S.C. § 78m(a). In constructing an appropriate disclosure regime, investors were to be given "an intelligent basis for forming [their] judgment as to the value of the securities" purchased or sold in the markets. In a system premised upon full disclosure, "true and accurate corporate reporting" had "vital importance. . . ." H.R. Rep. No. 1383, 73rd Cong., 2d Sess. 11 (1934).

Under the existing reporting regime, public companies with a class of securities registered with the SEC must file periodic reports, including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K. Although each form contains a separate set of disclosure obligations, they most commonly reference the requirements embodied in Regulation S-K, a master set of instructions for periodic reports, registration statements, and schedules required to be filed under the federal securities laws. 17 C.F.R. § 229.10, et seq. *See also* Adoption of Integrated Disclosure System, Exchange Act Release No. 18,524, 47 Fed. Reg. 11380, * 1 (Mar. 3, 1982) (Regulation S-K is a "repository for the uniform disclosure

requirements of documents filed with the Commission"). Regulation S-K is a primary touchstone of the integrated disclosure system created more than three decades ago under the federal securities laws. *See* Michael D. Guttentag, *Patching a Hole in the JOBS Act: How and Why to Rewrite the Rules that Require Firms to Make Periodic Public Disclosures*, 88 INDIANA L. J. 151, 178-90 (2013) (summarizing evidence that the SEC mandatory disclosure regime is value-enhancing).

A critical part of that regulatory architecture, MD&A appears in both annual and quarterly reports. Under Item 303, MD&A must include a discussion of liquidity, capital resources, and results of operations. 17 C.F.R. § 229.303. In 2002, Congress mandated additional disclosure in the MD&A, including a discussion of off-balance sheet arrangements and certain contractual obligations. *See* Sarbanes-Oxley Act of 2002 § 401 (adding 15 U.S.C. § 78m(j)). *See also* 17 C.F.R. § 229.303(a)(2)(ii) & (a)(4). For the most part, MD&A disclosure applies to information deemed material. Item 303, however, also requires the disclosure of *known* trends or uncertainties "reasonably likely" to have certain effects or that management "reasonably expects" to have a material impact on specified items. *See*, *e.g.*, *id.* at § 229.303(a)(1), (a)(3)(ii) & (a)(4)(i)(D).

Providing insight into both historical and future financial performance, MD&A has been described as the "keystone" to the integrated disclosure system and "[o]ne of the most important elements necessary to an

understanding of a company's performance. . . ."[6] Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Exchange Act Release No. 48,960, 68 Fed. Reg. 75055, * 10 (Dec. 29, 2003).

A. The Requirement that Companies Provide Disclosure under the Periodic Reporting Process Creates a Duty to Disclose Under the Antifraud Provisions

The antifraud provisions under the federal securities laws do not impose a general duty to disclose all material information. As a result, "issuers retain some control over the precise timing of many important corporate disclosures." Selective Disclosure and Insider Trading, Exchange Act Release No. 42,259, 64 Fed. Reg. 72590, * 3 (Dec. 28, 1999).

The discretion with regard to the "precise timing" of the disclosure of "important corporate" matters ceases, however, when issuers have a duty to disclose. In those circumstances, silence is no longer permitted. As this Court held in *Omnicare, Inc. v. Laborers Dist.*

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[6] Linda C. Quinn, Dir., Div. of Corp. Fin., Statement at The Roundtable on the Integration of the 1933 and 1934 Acts, SEC Historical Society, William O. Douglas Open Meeting Room, U.S. Securities and Exchange Commission, Washington, D.C., at 96 (Mar. 21, 2002) (statement by former director, Division of Corporation Finance, SEC); *see also Accounting and Investor Protection Issues Raised by Enron and Other Public Companies*: Before the United States Senate Committee on Banking, Housing, and Urban Affairs, 107th Congress (2002) (Written testimony of Harvey L. Pitt, Chairman, SEC) (Mar. 21, 2002).

Council Constr. Indus. Pension Fd., ___ U.S. ___, 135 S. Ct. 1318, 1331 (2015), such a duty exists where disclosure is necessary to avoid "half-truths." The mandatory disclosure requirements imposed by the Commission on reporting companies also create a legal obligation to speak. These rules and regulations dictate the content of relevant reports and the timing of disclosure, eliminating the right to remain silent.

The imposition of a "legal obligation" to speak, therefore, creates a duty under the "commonly accepted meaning" of that term. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 (1976); *see also Definition of Duty in English*, OXFORD LIVING DICTIONARIES (definition of "duty" includes "[a] moral or legal obligation; a responsibility").[7] This established understanding of the duty to disclose has long been recognized by

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[7] https://en.oxforddictionaries.com/definition/us/duty (last visited Aug. 6, 2017).

academics[8] and understood by Congress.[9] The language of Section 11 does not dictate a different result.[10]

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[8] *See* Arthur Fleischer, Jr., *"Federal Corporation Law": An Assessment*, 78 HARV. L. REV. 1146, 1157 (1965); *see also* Wendy Gerwick Couture, *A Glass-Half-Empty Approach to Securities Regulation*, 76 MD. L. REV. 360, 397 (2017); G. Mitu Gulati, *When Corporate Managers Fear a Good Thing is Coming to an End: The Case of Interim Nondisclosure*, 46 UCLA L. REV. 675, 727 (1999); Heminway, *supra* note 4, at 758; Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639, 1653 (2004); Dale Arthur Oesterle, *The Inexorable March Toward a Continuous Disclosure Requirement for Publicly Traded Corporations: "Are We There Yet?"*, 20 CARDOZO L. REV. 135, 140-41 (1998).

[9] Congress, in adopting the Private Securities Litigation Reform Act of 1995 ("PSLRA"), understood that misrepresentation claims could be based upon the omission of required disclosure. In the PSLRA, Congress amended Section 12 of the 1933 Act by providing an affirmative defense for loss causation. *See* Pub. L. No. 104-67, 109 Stat. 737 (1995) (Section 105 of the Securities Act of 1933). The defense applied to actions "described in subsection (a)(2)" where liability was premised upon the omission of a material fact "required to be stated therein. . . ." 15 U.S.C. § 77l(b). The language suggests that, in adopting Section 12(b), Congress understood that actions under Section 12(a)(2) could be based upon the omission of required disclosure. Given the substantially identical language in Section 12(a)(2) and Rule 10b-5(b), *see infra* note 14, the same awareness by Congress presumably applies to actions under Rule 10b-5(b).

[10] Section 11 permits a claim for false and misleading disclosure and for an omission of material fact "required to be stated therein. . . ." 15 U.S.C. § 77k(a). The phrase reflected a concern not with fraud but with the need for investors to be fully informed when making an investment decision. *See* 15 U.S.C. § 77g (setting out detailed content requirements for registration statements). Omissions of required disclosure did not need to result in fraud. Instead, they deprived investors of the information deemed necessary by Congress for an informed investment decision. *See* E.

Although ordained by the textual language, the existence of a duty to disclose in connection with required disclosure in periodic reports is further compelled by the longstanding position of the Commission. The Commission has affirmatively recognized that the periodic reporting process gives rise to a duty to disclose under the antifraud provisions. The view has been expressed in releases. *See* Selective Disclosure and Insider Trading, Exchange Act Release No. 43,154, 65 Fed. Reg. 51715, * 20 n. 86 (Aug. 24, 2000); *see also* Regulation of Takeovers and Security Holder Communications, Exchange Act Release No. 40,633, 63 Fed. Reg. 67331, * 8 (Dec. 4, 1998) (noting that duty to disclose under Rule 10b-5 trigged by "among other things: (1) line-item disclosure requirements in filings with the Commission"). The position has also been asserted in litigation. *See S.E.C. v. Conaway*, 698 F. Supp. 2d 771, 834 (E.D. Mich. 2010). *See also* Brief of the SEC as Amicus Curiae in Support of Plaintiff-Appellee, Urging

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Merrick Dodd, Jr., *Amending the Securities Act. The American Bar Association Committee's Proposal*, 45 YALE L. J. 199, 216 (1935). Investors deprived of the required disclosure, therefore, did not have to show damages from fraud but instead were allowed to change their mind and rescind. *See* William O. Douglas & George E. Bates, *The Federal Securities Act of 1933*, 43 YALE L. J. 171, 174 (1933). The right of rescission was, however, eliminated the following year. *See Civil Liability for Misstatements in Documents Filed Under Securities Act and Securities Exchange Act*, 44 YALE L. J. 456, 458 (1935). Unlike Section 11, Rule 10b-5(b) is predicated not upon the need for full disclosure but upon the need to prevent false and misleading disclosure. The language in Section 11 concerning facts "required to be stated" therefore has no bearing on the analysis of the language of Rule 10b-5(b).

Affirmance, *Finnerty v. Stiefel Laboratories, Inc.*, 756 F.3d 1310 at 10 n. 2 (11th Cir. 2014).

Likewise, administrative proceedings brought under the antifraud provisions have been explicitly premised upon the nondisclosure of information required as part of the periodic reporting process, including:

- "related party" transactions under Item 404, *see In re DeGeorge Fin. Corp.*, Exchange Act Release No. 39,319, 1997 WL 700691, at * 4 (admin. proc. Nov. 12, 1997);
- governance requirements in Item 401, *see In re Ciro Inc.*, Exchange Act Release No. 34,767, 1994 WL 548994, at * 5 (admin. proc. Sept. 30, 1994); and
- MD&A information mandated by Item 303. *See In re Presstek, Inc.*, Exchange Act Release No. 39,472, 1997 WL 784548, at * 13 (admin. proc. Dec. 22, 1997); *In re Cypress Bioscience Inc.*, Exchange Act Release No. 37,701, 1996 WL 531656, at * 7 (admin. proc. Sept. 19, 1996).

The existence of a duty to disclose has also been confirmed by the Commission's rulemaking activities. On at least two occasions, the Commission has added safe harbors to disclosure requirements adopted under Section 13(a) explicitly to avoid the creation of a duty to disclose under the antifraud provisions. This occurred in connection with disclosure mandated by Regulation FD, *see* 17 C.F.R. § 243.102, and disclosures triggered by some current reports on Form 8-K. *See* 17

C.F.R. § 240.13a-11(c). The Commission's established, consistent and longstanding positions, particularly in the context of rulemaking, are entitled to substantial deference under both *Chevron U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984), and *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

The interpretation of the term "duty" to include a legal obligation to disclose information required by a specific regulatory directive is also informed by, and consistent with, the common law. As a general rule, nondisclosure under the common law did not result in an action for fraud. *See Peek v. Gurney* [1873] LR 6 (HL) 377. Arising out of notions of *caveat emptor*, the approach reflected the "traditional ethics of bargaining between adversaries, in the absence of any special reason for the application of a different rule." RESTATEMENT (SECOND) OF TORTS § 551 cmt. k (Am. Law Inst. 1977) (liability for nondisclosure). With *caveat emptor* discarded in the context of the federal securities laws, however, the rational has little application with respect to the antifraud provisions. *See Santa Fe Indus. v. Green*, 430 U.S. 462, 477 (1977).

Even under the common law, however, silence was actionable where a duty to disclose existed. *See* RESTATEMENT (SECOND) OF TORTS § 551 (Am. Law Inst. 1977) (liability for nondisclosure); *see also* W. PAGE KEETON, ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 738 (Page Keeton ed., 5th ed., 1984). As state courts have broadly recognized, such a duty can arise where the legal obligation to speak has been imposed by regulation or statute. *See, e.g., Rodopoulos v. Sam*

Piki Enters', Inc., 570 So. 2d 661, 665 (Ala. 1990); *DiMichele v. Perrella*, 120 A.3d 551, 554 (Conn. App. 2015); *Binette v. Dyer Library Ass'n*, 688 A.2d 898, 903-04 (Me. 1996); *Williams v. East Coast Sales, Inc.*, 298 S.E.2d 80, 82 (N.C. Ct. App. 1982); *Lindner Fund, Inc. v. Waldbaum Inc.*, 624 N.E.2d 160, 161 (N.Y. 1993); *Gnagey Gas & Oil Co. v. Pa. Underground Storage Tank Fund*, 82 A.3d 485, 504 (Pa. Comm. Ct. 2014); *Favors v. Matzke*, 770 P.2d 686, 690 (Wash. Ct. App. 1989). Commentators have also acknowledged that a duty to disclose can arise from a regulatory or statutory mandate. *See* DAN B. DOBBS, PAUL T. HAYDEN AND ELLEN M. BUBLICK, DOBBS' LAW OF TORTS § 682 Nondisclosure (2d ed. June 2017 Update); *see also* Robert M. Washburn, *Residential Real Estate Condition Disclosure Legislation*, 44 DEPAUL L. REV. 381, 393 (1995).

The common law likewise makes actionable the deliberate concealment of information resulting in a "false impression" that "what is disclosed is the whole truth. . . ." *Stewart v. Wyo. Cattle Ranche Co.*, 128 U.S. 383, 388 (1888). A "false impression" of this kind can prevent further investigation that affects investment decisions. *See* RESTATEMENT (SECOND) OF TORTS § 550 (Am. Law Inst. 1977) (liability for fraudulent concealment); *see also* W. PAGE KEETON, ET AL., PROSSER AND KEETON ON THE LAW OF TORTS 738 (Page Keeton ed., 5th ed., 1984) ("Any words or acts which create a false impression covering up the truth, or which remove an opportunity that might otherwise have led to the discovery of a material fact . . . are classed as misrepresentation, no less than a verbal assurance that the fact

is not true."). This "silent fraud" can arise from the failure to disclose information required by statute. *See A.D. Transp. Inc. v. Mich. Materials & Aggregates Co.*, Nos. 290236, 290250, at * 4 (Mich. Ct. App. Sept. 30, 2010); *see also Zimmerman v. Northfield Real Estate, Inc.*, 510 N.E.2d 409, 413 (Ill. App. 1987).

These common law principles are reflected in this Court's opinion in *Omnicare*. There, this Court recognized that, under the common law, omitted facts could give rise to a duty to disclose where necessary to rebut an otherwise "predictable inference." Moreover, such a duty existed where the speaker was understood to have "special knowledge" unavailable to the recipient. *Omnicare*, 135 S. Ct. at 1331.

Consistent with this reasoning, a periodic report could "mislead its audience" by projecting the "predictable inference" that the contents of a periodic report included the information required by the SEC when in fact it did not.[11] In those circumstances, investors would assume that matters required to be disclosed

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[11] The filing of a periodic report is accompanied by an implied representation that the contents will conform to the mandatory disclosure requirements, *see* Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763, 816 n. 157 (1995), a concept already built into the jurisprudence under the antifraud provisions. *See Grandon v. Merrill Lynch & Co.*, 147 F.3d 184, 192 (2d Cir. 1998) (discussing the "shingle theory" of liability whereby Rule 10b-5 creates an implied duty on the part of a securities dealer to disclose excessive markups by "hanging out its professional shingle").

had not occurred or did not exist.[12] As a result, they would be operating under a "false impression" with respect to the company's operations or business and would not be making an investment decision on the basis of "true and accurate corporate reporting. . . ." The court below was therefore correct in concluding that investors could be misled by the omission of a material adverse uncertainty required to be disclosed under Item 303.

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[12] As we discuss elsewhere in this brief, the view by investors may not be merely "inferred" but rather based upon affirmative statements of compliance with legal requirements. The chief executive officer and chief financial officer must certify the accuracy of the annual report on Form 10-K and the quarterly reports on Form 10-Q. The officers must represent that they are unaware of any "untrue statement of material fact" or material omissions and that the financial statements and information "fairly present in all material respects the financial condition, results of operations and cash flows" of the company. Rule 13a-14(a), 17 C.F.R. § 240.13a-14(a). *See also* Regulation S-K Item 601(b)(31), 17 C.F.R. § 229.601(b)(31) (setting out the language required for the certification). The requirement that reports "fairly present" a company's financial condition applies to MD&A disclosure. *See* Certification of Disclosure in Companies' Quarterly and Annual Reports, Exchange Act Release No. 46,427, 67 Fed. Reg. 57275, * 6 (Aug. 28, 2002). In addition, officers must certify that the Report "complies with the requirements of Section 13(a). . . ." 18 U.S.C. § 1350; *see also* Rule 13a-14(b), 17 C.F.R. § 240.13a-14(b). Based upon both sets of representations, reasonable investors would believe that the periodic reports contained all mandatory disclosures.

B. The Reaffirmation of a Duty to Disclose with Respect to Required Disclosure Will Not Result in "Massive Liability" or Efforts to Enforce Technical Violations of the Periodic Reporting Requirements

The reaffirmation of a duty to disclose in these circumstances will not, as Petitioner asserts, create a threat of "massive liability" or transform investors into the enforcers of "thousands of technical reporting requirements." Brief of Petitioner, at 16-17. These assertions are based upon the assumption that this Court is being asked to create a duty that has previously not existed. That is simply not the case.

Until the 9th Circuit's decision in *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d 1046 (9th Cir. 2014), no circuit court had unequivocally ruled out the existence of a duty to disclose arising out of mandatory disclosure requirements in an action arising under Section 10(b) and Rule 10b-5(b).[13] Circuit courts either found a duty

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[13] Petitioner has identified only two appellate courts that have "rejected" the determination that Item 303 creates a duty to disclose. *See* Brief of Petitioner at 19 (citing *NVIDIA* and *see Oran v. Stafford*, 226 F.3d 275 (3d Cir. 2000)). We agree, however, with the Second Circuit's interpretation that *Oran* did not find an absence of a duty to disclose for required disclosure. *See Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 103-04 (2d Cir. 2015). We note that in the aftermath of the decision in *Oran*, investors continued to file claims under Item 303, with courts resolving the claims on grounds other than the absence of a duty to disclose. *See In re Hertz Global Holdings, Inc. Sec. Litig.*, 2017 WL 1536223, * 19 n. 7 (D.N.J. Apr. 27, 2017); *Messner v. USA Technologies, Inc.*, 2016 WL 1466543, * 4 (E.D. Pa. Apr. 13, 2016); *In re Campbell Soup Co. Sec. Litig.*, 145 F. Supp. 2d 574, 591 (D.N.J. 2001).

to disclose, assumed a duty to disclose, or declined to address the issue. Likewise, courts routinely agreed or assumed that Sections 11 and 12(a)(2) of the 1933 Act permitted claims for nondisclosure of required information.[14]

Investors have, therefore, generally been free to assert claims alleging the failure to comply with the mandatory disclosure requirements under the federal securities law and issuers have been counseled accordingly. *See* William R. Rohrlich II, *Disclosure Implications of Recent Developments in SEC Compliance*, in SEC COMPLIANCE BEST PRACTICES, 2015 ED.: LEADING LAWYERS ON UNDERSTANDING NEW REGULATIONS AND DEVELOPING COMPLIANCE STRATEGIES (INSIDE THE MINDS), 2015 WL 5565388, at * 4 (2015) ("Until the circuit split is resolved by the Supreme Court, if at all, registrants should assume that failure to meet the disclosure requirements under Item 303 could subject them to Section 10(b) and Rule 10b-5 claims for securities fraud."). *See also* THOMAS J. DOUGHERTY, THE DIRECTOR'S HANDBOOK, Appendix B (2017) ("A company has a duty to disclose . . . when a law or regulation requires it (annual and quarterly reports, registration or in the event of selective disclosure)"). Moreover, despite the existing latitude to bring these claims, the number of actions filed by investors has apparently been quite

[14] This is the case even though Section 12(a)(2) contains language very similar to Rule 10b-5(b). *See Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 102 (2d Cir. 2015) ("Like Section 12(a)(2), Rule 10b-5 requires disclosure of 'material fact[s] necessary in order to make . . . statements made . . . not misleading.' ").

modest and has certainly not resulted in "massive liability" or generated widespread efforts to enforce "technical reporting requirements."[15]

The explanation for this result is straightforward. The existence of a duty to disclose arising from the omission of required information under the system of periodic reporting neither obviates the need to allege the other elements of fraud nor mitigates the obligation to meet the elevated pleading standards applicable to these actions, including the requirement in investor litigation of a "strong inference" of scienter.[16] The claims pose a particularly serious challenge to investors to establish that the nondisclosures resulted in causal loss. Moreover, as a practical matter, even when these and other substantive requirements can be met,

[15] We base this statement on our collective experience. We note, however, that a search of reported district court opinions in the 9th Circuit, one of the most common locations for securities fraud cases (*see* Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review*, NERA 11 (Jan. 2017) ("Filings continued to be concentrated in the Second and Ninth Circuits, where more cases were filed than in all other circuits combined")), revealed less than 40 unique cases brought by investors between 1988 and 2017 that cited Item 303, a modest number at best.

[16] *See Litwin v. Blackstone Grp, L.P.*, 634 F.3d 706, 723 (2d Cir. 2011) (in addition to duty to disclose, the need to establish materiality provides "sufficient protection against the opening-of-the-flood-gates argument advanced by [defendant] and accepted by the District Court.").

investors are unlikely to bring actions for nondisclosure where the damages are insufficient to permit a meaningful recovery.[17]

The difficulty in bringing fraud claims in the case of nondisclosure is more than surmise. Cases are commonly dismissed in high percentages. *See* Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2016 Full-Year Review*, NERA 25 (Jan. 2017) ("Between 2008 and 2011, the most recent years with a substantial resolution rate, about half of the cases filed were dismissed."). Allegations relating to the omission of disclosure required by Item 303 have been dismissed for failing to sufficiently allege materiality, failing to allege scienter, or failing to allege knowledge of a trend or uncertainty. Moreover, costs to issuers are minimized during the pendency of a motion to dismiss as a result of a stay of discovery. *See* 15 U.S.C. § 78u-4.

Accordingly, a reaffirmation by this Court of a duty to disclose arising from mandatory requirements under federal securities law will, at most, modestly impact enforcement by investors. An explicit endorsement of that duty to disclose by this Court will provide

[17] Investors will need to incur the damages necessary to address the costs associated with maintaining such an action. Admittedly an extreme case, lead counsel in the Enron case absorbed approximately $45 million in expenses and 280,000 hours of time case prior to settlement and approval of the fee request. *See Newby v. Enron Corp*., 586 F. Supp. 2d 732, 774 (S.D. Tex. 2008) (noting that lead counsel advanced "over $45 million in expenses and 280,000 hours of time").

some additional clarity in circuits that have not squarely addressed the issue. In those circuits, however, investors have already been able to bring claims premised upon the failure to disclose information required in periodic reports. A meaningful increase in these actions is therefore unlikely.

Affirming the existence of a duty to disclose will alter the law in the 9th Circuit. Such actions, however, have only been foreclosed since 2014. Moreover, the decision in *NVIDIA* applied only to claims under Rule 10b-5(b) and did not prevent actions for disclosure under Sections 11 or 12(a)(2) of the 1933 Act.

Indeed, even in that Circuit, claims could be maintained in some circumstances for nondisclosure of required information in periodic reports. Under Section 11, nondisclosure of trends, uncertainties, and other required information in periodic reports – the very issue in this case – would be actionable to the extent such reports were incorporated by reference into a registration statement, a not uncommon phenomena for public companies. *See In re Caine*, Exchange Act Release No. 55,476 (admin. proc. March 15, 2007) (finding that "Form S-3 incorporated prior filings by reference and thus repeated the false and misleading statements from those periodic reports. In addition, the Form S-3 did not disclose the material and adverse trends and uncertainties that were known to management at the time concerning the commuters."). Given that, it is implausible that positive law or public policy dictates a different result when the cause of action is premised directly on the same disclosure lapse.

C. Eliminating Fraud Actions for Nondisclosure of Information Required by Item 303 and other Provisions of Regulation S-K Will Impair the Quality of the System of Periodic Reporting

While reaffirmation of a duty to disclose will not result in "massive liability" or widespread enforcement of "technical violations," the failure to do so will substantially weaken enforcement of the periodic reporting regime applicable to public companies. A holding that repudiates the existence of a duty to disclose in this context will at best provide additional incentives for nondisclosure and at worst provide protection for the deliberate concealment of material information. The increased incentives favoring nondisclosure will have the capacity to create a "regulatory lottery," with issuers more willing to make decisions about disclosure on the basis of the risk of detection and the reduced likelihood of enforcement.

1. Existing Levels of Enforcement Have Not Resulted in Adequate Levels of Compliance with Item 303 of Regulation S-K

The failure to affirm a duty to disclose will harm the system of required disclosure for public companies by reducing deterrence for noncompliance, a particular concern with respect to nondisclosure.[18] Nondisclosure

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[18] *See* Joel Seligman, *Rethinking Private Securities Litigation*, 73 U. CIN. L. REV. 95, 116 n. 99 (2004) ("[T]he history of the SEC and federal securities law, perhaps above all else, has taught that no mandatory disclosure system, no regulatory requirement

can raise difficult issues of detection.[19] The periodic reporting requirements compel disclosure of many facts that would otherwise remain unknown to investors. Absent compliance with the mandatory disclosure rules, investors are unlikely to ever learn about related party transactions subject to Item 404, 17 C.F.R. § 229.404, compensation matters mandated by Item 402, 17 C.F.R. § 229.402, or undisclosed trends and uncertainties required by Item 303. 17 C.F.R. § 229.303. Such matters can be material to investors and affect investment decisions.

A review of the MD&A disclosure produced over the last four decades illustrates the risks that will accompany any reduction in enforcement authority. Item 303 has resulted in inadequate disclosure. Although describing the purpose of the MD&A as "not complicated," *see* Exchange Act Release No. 48,960, *supra*, * 2, the Commission has deployed an extraordinary mix of resources designed to ensure compliance. These have included:

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or prohibition, no SEC review ultimately will effectively work unless the relevant statute or rule is consistently enforced. Periodically the SEC has received an inadequate budget and been understaffed. Private enforcement, warts and all, endures as a pivotal means to ensure law compliance.").

[19] With respect to affirmative statements, investors are in a position to investigate the accuracy of the representations. They can, for example, seek additional information from the company through the use of inspection rights under state law. *See* Delaware General Corporation Law § 220. In the case of nondisclosure, however, investors would often remain entirely unaware of the matter. Further investigation would not, therefore, be possible.

- the systematic review of SEC filings, *see* Business and Financial Disclosure Required by Regulation S-K, Exchange Act Release No. 77,599, 81 Fed. Reg. 23915, * 49 (April 22, 2016);
- the publication of "cautionary advice," *see* Accounting Policies; Cautionary Advice Regarding Disclosure, Exchange Act Release No. 45,149, 66 Fed. Reg. 65013 (Dec. 17, 2001);
- the monitoring of earnings calls, *see* Elisse B. Walter, Comm'r, SEC, Remarks Before WESFACCA: Let the Story Shine Through (Mar. 5, 2010);
- the issuance of multiple releases providing detailed guidance on appropriate disclosure, *see* Management's Discussion and Analysis of Financial Condition and Results of Operations, Exchange Act Release No. 18,120, 23 SEC Docket 962 (Sept. 28, 1981) (release not published in Federal Register), Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Exchange Act Release No. 26,831, 54 Fed. Reg. 22427 (May 18, 1989); Exchange Act Release No. 48,960, *supra*; and
- the filing of enforcement proceedings, including those premised upon violations of the antifraud provisions. *See In re Presstek, Inc.*, Exchange Act Release No. 39,472, 1997 WL 784548 (admin. proc. Dec. 22, 1997).

Despite the prodigious efforts, adequate compliance has remained elusive. In the early years of the MD&A, a chair of the Commission described the disclosure as an embarrassment. *See* Harold M. Williams, Chairman, SEC, Address at the Financial Executives Institute: Current Problems in Financial Reporting and Internal Controls 9 (Oct. 9, 1979). Officials at the SEC have expressed "great concerns" with MD&A disclosure compliance, Linda C. Quinn, Dir., Div. of Corp. Fin., Statement at The Roundtable on the Integration of the 1933 and 1934 Acts, SEC Historical Society, William O. Douglas Open Meeting Room, U.S. Securities and Exchange Commission, Washington, D.C., at 97 (Mar. 21, 2002), and described the contents of MD&A as "quite troubling. . . ." Remarks by SEC Commissioner Walter, *supra*.[20]

The Commission has characterized MD&A in "too many companies" as "difficult to understand and confusing. . . ." *see* Exchange Act Release No. 48,960, *supra*, * 5, and, as recently as 2016, found the disclosure as "less detailed" than desired and in need of "greater analysis" and "additional explanations. . . ." *See* Exchange Act Release No. 77,599, *supra*, * 49. One director of the Division of Corporation Finance, the Division

[20] Concerns over the quality and content of MD&A have been echoed by public commentators, *see* Letter from Dennis M. Kelleher, President & CEO, et al., Healthy Markets, Inc., to Brent J. Fields, Sec'y, SEC, at 14 (July 21, 2016) (noting that "the lack of analysis in the MD&A is a matter of real concern."), and academics. *See* Stephen V. Brown & Jennifer Wu Tucker, *Large-Sample Evidence on Firms' Year-over-Year MD&A Modifications*, 49 J. ACCT. RES. 309, 312 (2011).

within the SEC responsible for the oversight and interpretation of Item 303, characterized the content as having “too much elevator music” and not enough “useful analysis.” Alan L. Beller, Dir., Div. of Corp. Fin., SEC, *Integration Roundtable*, *supra*, at 126.[21]

Targeted attempts to improve disclosure have not always worked. Efforts to increase discussions of important issues such as cybersecurity in the MD&A, *see* DIV. OF CORP. FIN., SEC, CF DISCLOSURE GUIDANCE: TOPIC NO. 2 (Oct. 13, 2011), have apparently failed. *See* Tatyana Shumsky, *Corporate Judgment Call: When to Disclose You’ve Been Hacked*, WALL ST. J. (Sept. 19, 2016 5:31 PM). In addition, as some have asserted, MD&A disclosure requirements did not function sufficiently to provide adequate warning of the capital and liquidity problems that surfaced in the financial crisis of 2008. *See* Letter from Kurt N. Schacht, CFA, Managing Director, Standards and Advoc., CFA Inst., and James C. Allen, CFA, Head, Cap. Mkts. Pol. – Americas, CFA Inst., to Brent J. Fields, Sec’y, SEC, at 5 (Oct. 6, 2016).[22]

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[21] The omissions may not always be a matter of mistaken judgment. One commissioner (and later Chair) at the SEC even suggested that omissions were potentially deliberate, with some companies possibly “wait[ing] to make disclosures” until prodded by the Commission. Elisse B. Walter, Comm’r, SEC, Remarks Before WESFACCA: Let the Story Shine Through (Mar. 5, 2010).

[22] Nor were these concerns entirely unnoticed. The staff of the Division of Corporation Finance issued letters in 2008 raising concerns with MD&A disclosure on matters that could affect liquidity and capital resources. *See* Sample Letter from the Senior Assistant Chief Accountant, Division of Corporation Finance,

Despite the SEC's repeated laments about poor compliance, there have been few investor or government enforcement actions premised on a failure to comply with Item 303. *See supra* note 15; *see also* Petitioner's Brief, at 43 (noting that Commission has "brought fewer than 100 actions alleging noncompliance with Item 303" in the decades since the adoption of Regulation S-K). This likely reflects the formidable burdens faced by investors and the SEC in establishing, by a preponderance of the evidence, violations of Item 303. The determination that a duty to disclose does not exist for the failure to comply with Item 303 would additionally reduce the tools available for ensuring compliance. Given the already challenging environment, particularly with respect to MD&A, a reduction in enforcement will further compromise these efforts.

2. The Failure to Find a Duty to Disclose Will Significantly Reduce Enforcement of the Periodic Reporting Requirements and the Deterrence of Noncompliance

Absent a duty to disclose, private enforcement under Rule 10b-5(b) for fraudulent nondisclosure of information required in periodic reports will effectively be

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Sent to Public Companies on MD&A Disclosure Regarding the Application of SFAS 157 (Fair Value Measurements), Sept. 16, 2008; Sample Letter from the Senior Assistant Chief Accountant, Division of Corporation Finance, Sent to Public Companies on MD&A Disclosure Regarding the Application of SFAS 157 (Fair Value Measurements), March 27, 2008.

eliminated.[23] Even where investors subsequently learn about the concealment of material information, recourse may well be left to the Commission. The Commission's decision to initiate an investigation and bring an enforcement proceeding will depend upon administrative constraints and uncertainties and will not be guaranteed.[24]

At the same time, the reversal of the lower court's decision in this case will directly affect the Commission's enforcement capabilities. As with investors, the SEC must allege a duty to disclose to maintain an

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[23] *But see supra* note 5. The Exchange Act includes a private right of action in Section 18 for "false and misleading" statements in documents filed with the Commission. 15 U.S.C. § 78r. Section 18, however, does not expressly sanction actions based on deceptive or fraudulent omissions to state material facts. Moreover, a cause of action brought under Section 18 is largely unavailable to investors, at least those seeking class action status. *See Howard v. Everex Systems, Inc.*, 228 F.3d 1057, 1063 (9th Cir. 2000) (Section 18 requires evidence of "actual reliance" and, as a result, "is not a sufficient replacement for suits under § 10(b). . . ."). To the extent that a court were to find that successful Section 18 actions based on nondisclosure require the existence of a duty to disclose, the reversal of the lower court in this case would eliminate a cause of action of that kind under Section 18.

[24] *See supra* note 18. Nor will the Commission necessarily obtain sufficient recovery to compensate investors. The Commission generally seeks disgorgement and penalties while investors seek damages. The two amounts are not the same. *See* Joseph A. Grundfest, *Damages and Reliance Under Section 10(b) of the Exchange Act*, 69 BUS. LAW. 307, 311 (Feb. 2014) (noting that "class action plaintiffs can assert large damage claims, far in excess of the measure that would be available under a disgorgement rule"). Moreover, amounts obtained as disgorgement may not be paid to "victims" but instead "dispersed" to the U.S. Treasury. *See Kokesh v. S.E.C.*, ___ U.S. ___, 137 S.Ct. 1635, 1644 (2017).

action under Rule 10b-5(b). The SEC, therefore, will no longer be able to bring claims under Rule 10b-5(b) based upon the nondisclosure of information mandated in Regulation S-K.[25] Notwithstanding the fact that its own rules require disclosure, the Commission will be forced to look elsewhere to find a duty to disclose.

The loss of Rule 10b-5(b) as an enforcement and deterrence tool will be significant. The provision has significant capacity to deter. Fraud claims under the provision can include an officer and director bar, *see* Section 21(d)(2), 15 U.S.C. § 78u(d)(2), a particularly "feared" remedy. *See* Luis Aguilar, Comm'r, SEC, Speech at the Securities Enforcement Forum 2012: *Taking a No-Nonsense Approach to Enforcing the Federal Securities Laws* (Oct. 18, 2012). Individuals can be liable as primary violators.[26] Actions for fraud also can

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[25] The absence of a duty to disclose may impact the SEC's enforcement authority under other provisions of the federal securities laws. Rule 10b-5(b) and Section 17(a)(2) of the 1933 Act use similar language. *See Walck v. Am. Stock Exch.*, 687 F.2d 778, 789 n. 16 (3d Cir. 1982) ("Section 17(a) is substantively identical to Rule 10b-5"). Moreover, such a determination could narrow enforcement by state regulators. Section 501 of the Uniform Securities Act of 2002 includes a prohibition on securities fraud. The provision is "modeled on Rule 10b-5 adopted under the Securities Exchange Act of 1934 and on Section 17(a) of the Securities Act of 1933." REVISED UNIFORM SECURITIES ACT § 501 (Official Comment). Given the overlap in language, state courts often defer to and rely on federal interpretations. *See* Adam J. Gana & Michael Villacres, *Blue Skies for America in the Securities Industry . . . Except for New York: New York's Martin Act and the Private Right of Action*, 19 FORDHAM J. CORP. & FIN. L. 587, 591 (2014).

[26] An individual can be a primary violator of Rule 10b-5(b) to the extent qualifying as a "maker" of the false statement. *See Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135,

render unavailable safe harbors for the private placement of shares and forward-looking information. *See* 21E, 15 U.S.C. § 78u-5(b)(1); 17 C.F.R. § 230.506(d)(1)(v). These effects create the potential for severe reputational consequences, *see* Christopher F. Baum, James G. Bohn, & Atreya Chakraborty, *Securities Fraud and Corporate Board Turnover: New Evidence from Lawsuit Outcomes*, 48 INT'L REV. L. & ECON. 14, 16 (2016) (discussing literature indicating that filing of fraud actions can have a "negative impact on CEO careers"), and substantial harm to the business of an issuer. *See Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 96 (2d Cir. 2016).

The elimination of actions under Rule 10b-5(b) based on noncompliance with mandatory disclosure obligations will also affect the settlement of actions for nondisclosure brought under other provisions. Most actions brought by the SEC settle. *See* Note, Ross MacDonald, *Setting Examples, Not Settling: Toward a New SEC Enforcement Paradigm*, 91 TEX. L. REV. 419, 421 (2012) ("The Commission currently settles, in a manner not unlike the scenario described above, roughly 98% of its cases."). Even when fraud is not ultimately charged, the mere possibility of a claim under Rule 10b-5(b) has the potential to result in settlements that include more severe penalties or consequences, providing additional deterrence. Eliminating the possibility

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142 (2011) (noting that "maker" was the "person or entity with ultimate authority over the statement"). At least one circuit, however, has held that individuals may not be charged as primary violators under Section 13(a) of the Exchange Act. *See S.E.C. v. Jensen*, 835 F.3d 1100, 1118 (9th Cir. 2016).

of a claim for fraud under Rule 10b-5(b) as a result of nondisclosure of required information in periodic reports will reduce Commission leverage in negotiating these settlements.

The absence of claims under Rule 10b-5(b) could, therefore, affect the Commission's ability to deter violations of the periodic reporting requirements. With limited resources, the Commission cannot conduct every possible investigation or bring every viable case. Enforcement must instead reflect agency priorities. Deterrence of wrongdoing represents a key priority. *See* Mary Jo White, Chair, SEC, Speech at the IOSCO 39th Annual Conference: The Challenge of Coverage, Accountability and Deterrence in Global Enforcement (Oct. 1, 2014). Any reduction in the deterrent effect of SEC enforcement as a result of the loss of claims under Rule 10b-5(b) for the omission of required disclosures in periodic reports may well result in even fewer actions by the Commission to enforce these requirements.[27]

[27] With respect to Item 303, the result would be a reduction in the already modest number of actions. *See* Petitioner's Brief, at 43. Regulation FD provides an example of the consequences of an enforcement regime lacking in private enforcement and largely limited to actions by the Commission under Section 13(a). Because of a safe harbor included in the Regulation, actions for nondisclosure under Rule 10b-5(b) are generally unavailable. *See* 17 C.F.R. § 243.102. Mostly limited to actions under Section 13(a), the filing of enforcement actions have occurred "so infrequently" and involved penalties of "such a low magnitude that the regulation is unlikely to deter opportunistic selective disclosure in practice." Martin Bengtzen, *Private Investor Meetings in Public Firms: The Case for Increasing Transparency*, 22 FORDHAM J. CORP. & FIN. L. 33, 38 (2017).

CONCLUSION

The determination that a duty to disclose exists for purposes of actions based upon nondisclosure under Rule 10b-5(b) entails a straightforward application of the plain meaning of the nature and language of the mandatory disclosure rules that regulate the content of a public company's required reports. Quite simply, a disclosure mandate in law or agency rules creates a duty to disclose. Commentators and the Commission have long recognized this basic point. Disclosure required in periodic reports creates a legal obligation to speak, obviating an issuer's ability to remain silent. The reaffirmation by this Court of a duty to disclose in these circumstances will be consistent with existing practices.

On the other hand, the elimination of a duty to disclose will adversely affect the remedies available to investors and curtail enforcement tools possessed by the Commission, harming the system of mandatory disclosure. The holding will result in arbitrary distinctions among investors. Nondisclosure will be actionable if arising in connection with an offering under Sections 11 or 12(a)(2) but not if occurring in connection with transactions in the secondary markets under Rule 10b-5(b). This will be the case despite the fact that investors acquiring shares in an offering may have a claim for nondisclosure of required information in a periodic report (to the extent incorporated by reference into a 1933 Act registration statement) while other investors – including those purchasing or selling their shares in the public trading markets – will not have a cause of

action under Section 10(b) and Rule 10b-5(b) for the very same nondisclosure in the very same report.

In a regulatory regime built around "true and accurate corporate reporting," there is little doubt that the omission of required information can mislead. Investors will operate under the "predictable" inference that periodic reports contain the information required by the rules and regulations of the Commission. Particularly where officers certify the accuracy and completeness of the information provided in the reports, investors will have an explicit basis for the assumption. The omission of a required transaction, uncertainty, or trend, will create an inference that no such matter had occurred or existed. The absence of recourse by investors in these circumstances would reduce trust in the integrity of the system of disclosure and ultimately harm the securities markets.

In this case, investors alleged the omission of a material uncertainty required to be disclosed by Item 303. The MD&A in the annual report on Form 10-K filed by Petitioner in March 2011 included a section in the MD&A titled "Business Environments and Trends" (*see* JA 901) that noted the existence of "a number of additional risks and uncertainties which could impact our U.S. Government business. . . ." JA 903. In another section of the MD&A titled "Commitment and Contingencies" a reference was made to the existence of "a number of reviews, investigations, claims, lawsuits and other uncertainties related to our business. . . ." *See* JA 928.

In neither of these sections did the report include a discussion of facts relating to the CityTime matter, the uncertainty alleged to have been omitted. In addition, officers certified the accuracy of the Report, *see* JA 1115 (certification of CEO under § 302 of Sarbanes-Oxley); JA 1118 (certification of CFO under § 302 of Sarbanes-Oxley), including a representation of conformity with the requirements mandated by Section 13(a). *See* JA 1122 (certification of CFO under § 906 of the Sarbanes-Oxley); JA 1122 (certification of CFO under § 906 of the Sarbanes-Oxley).

The Petitioner's alleged failure to comply with its regulatory obligation to disclose breaches a duty to disclose for purposes Section 10(b) and Rule 10b-5(b). Allegations of that failure should be permitted to proceed to adjudication.

For these reasons, *amici* respectfully urge this Honorable Court to affirm the ruling of the United States Court of Appeals for the Second Circuit.

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