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## Duty or No Duty? That Is the Question: The Second Circuit Reasserts That a Violation of Item 303's Duty to Disclose Can Establish Liability Under Section 10(b)

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# DUTY OR NO DUTY? THAT IS THE QUESTION: THE SECOND CIRCUIT REASSERTS THAT A VIOLATION OF ITEM 303'S DUTY TO DISCLOSE CAN ESTABLISH LIABILITY UNDER SECTION 10(B)

**Abstract:** On March 29, 2016, in *Indiana Public Retirement Systems v. SAIC, Inc.*, the United States Court of Appeals for the Second Circuit reaffirmed its earlier conclusion that a violation of the duty to disclose imposed on publicly traded companies by Item 303 of Regulation S-K can constitute a violation of Section 10(b) of the Securities Exchange Act of 1934. In so doing, the Second Circuit directly conflicted with a decision from the United States Court of Appeals for the Ninth Circuit, *Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Securities Litigation)*, despite the fact that both courts relied upon the Third Circuit's *Oran v. Stafford* opinion in reaching their decisions. This Comment argues that a violation of Item 303 can constitute a violation of Section 10(b), and, further, that the Second Circuit adopted the correct approach because it faithfully construed the underlying regulation and statute, correctly followed earlier jurisprudence, and furthered, not frustrated, the principal goals of the federal securities laws.

## INTRODUCTION

The dual goals of the federal securities laws are to regulate securities exchanges and to protect investors from abusive practices.<sup>1</sup> To effectuate those goals, the Securities and Exchange Commission (SEC) has implemented a rigorous disclosure scheme.<sup>2</sup> To that end, Rule 10b-5, promulgated under Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act), makes it unlaw-

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<sup>1</sup> See *Chadbourne & Parke LLP v. Troice*, 571 U.S. 377, 390 (2014) (noting that the federal securities laws seek to safeguard the exchanges and protect investors); *Crofoot v. Sperry Rand Corp.*, 408 F. Supp. 1154, 1156 (E.D. Cal. 1976) (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975)) (“The 1934 Act thus has the dual purpose of providing for the regulation of the securities and over-the-counter market and protecting the investor from inequitable and unfair practices . . .”). The two principal vehicles of federal securities regulation are the Securities Act of 1933, which governs the initial public offering of securities, and the Securities Exchange Act of 1934, which governs all facets of public securities transactions. THOMAS LEE HAZEN, *PRINCIPLES OF SECURITIES REGULATION* 16–17 (4th ed. rev. 2017).

<sup>2</sup> Matthew C. Turk & Karen E. Woody, *The Leidos Mixup and the Misunderstood Duty to Disclose in Securities Law*, 75 WASH. & LEE L. REV. 957, 968–69 (2018) (“The main tool used to reach [the goals of the federal securities laws] is the mandatory disclosure regime. The Securities Act of 1933 . . . and Securities Exchange Act of 1934 . . . [and] the attendant rules and regulations issued by the SEC, establish an elaborate regulatory framework based on this premise.”).

ful to omit or misstate any material fact.<sup>3</sup> Similarly, Item 303 of Regulation S-K (Item 303), requires select SEC-mandated reports to disclose trends or uncertainties of which the reporting company is aware, and which the company expects will adversely affect its economic outlook.<sup>4</sup>

In *Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Securities Litigation)*, the United States Court of Appeals for the Ninth Circuit held that a violation of the duty to disclose imposed by Item 303 does not establish liability under Section 10(b).<sup>5</sup> By contrast, in *Indiana Public Retirement Systems v. SAIC, Inc.*, the United States Court of Appeals for the Second Circuit, building upon its earlier decision in *Stratte-McClure v. Morgan Stanley*, recognized that a violation of Item 303's duty to disclose can constitute a violation of Section 10(b).<sup>6</sup> Though the United States Supreme Court granted certiorari in *SAIC*, a settlement one day prior to oral argument precluded resolution of the circuit split.<sup>7</sup> Thus, the split leaves lower courts, securities law practitioners, and corporate filers un-

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<sup>3</sup> Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012); 17 C.F.R. § 240.10b-5 (2018). Section 10(b) of the Exchange Act, the broad anti-fraud provision of the federal securities laws, makes it illegal for "any person, directly or indirectly . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . ." § 10(b). Rule 10b-5, promulgated thereunder, in pertinent part, 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." § 240.10b-5.

<sup>4</sup> 17 C.F.R. § 229.303(a)(3)(ii) (2018) (requiring corporate filers to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations"); see Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Exchange Act Release No. 33-6835, 54 Fed. Reg. 22,427 (May 18, 1989) [hereinafter Certain Investment Company Disclosures] (clarifying, in an interpretative release, the parameters of the disclosure obligation mandated by Item 303). Regulation S-K is a scheme of integrated disclosure enacted by the SEC to eliminate redundancy in an issuer's filing obligations under the Exchange Act and the Securities Act of 1933. 17 C.F.R. §§ 229.10–.1208 (2018); Turk & Woody, *supra* note 2, at 972. Regulation S-K requires disclosure covering numerous substantive areas of the reporting company's business, such as corporate governance and any pending litigation. Turk & Woody, *supra* note 2, at 972 n.69 (citing 17 C.F.R. §§ 229.10–.1208).

<sup>5</sup> *Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.)*, 768 F.3d 1046, 1056 (9th Cir. 2014).

<sup>6</sup> *Compare Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 94 n.7 (2d Cir. 2016) (reaffirming its position that Item 303 creates an affirmative duty to disclose, violation of which can establish a claim under Section 10(b)), and *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 101 (2d Cir. 2015) (concluding that a violation of Item 303's affirmative duty to disclose can constitute a violation of Section 10(b)), with *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1056 (holding that a violation of Item 303's duty to disclose does not establish a violation of Section 10(b)).

<sup>7</sup> Turk & Woody, *supra* note 2, at 960 (noting that the Supreme Court was unable to resolve the doctrinal issues in *SAIC* because of a last-minute settlement). The Supreme Court formally dismissed the writ of certiorari in June 2018 pursuant to a joint petition by the parties. Stipulation to Dismiss the Writ of Certiorari at 1, *Leidos, Inc. v. Ind. Pub. Ret. Sys.*, 137 S. Ct. 1395 (2017) (No. 16-581).

certain of whether a violation of Item 303's duty to disclose can serve as the basis for a Section 10(b) violation.<sup>8</sup>

Part I of this Comment describes the facts of *SAIC* that led to the lawsuit, the Second Circuit's disposition of the case, and provides an overview of the disclosure obligations mandated by the federal securities laws.<sup>9</sup> Part II examines the different positions the circuits have taken on the issue of whether a violation of Item 303's duty to disclose can serve as a basis for liability under Section 10(b).<sup>10</sup> Part III analyzes the Second Circuit's decision in *SAIC* and concludes it is more persuasive than the Ninth Circuit's reasoning and outcome.<sup>11</sup>

## I. THE FACTS AND HISTORY OF *SAIC* AND THE DISCLOSURE REQUIREMENTS OF THE FEDERAL SECURITIES LAWS

Section A of this Part discusses the factual background of the Second Circuit's *SAIC*.<sup>12</sup> Section B details the procedural history of *SAIC*.<sup>13</sup> Section C provides an overview of the disclosure obligations required by the federal securities laws.<sup>14</sup>

### A. *SAIC's Factual History*

In 2000, New York City retained SAIC, Inc. (SAIC) as the primary contractor on a government project to create and deploy CityTime, an automated time-keeping program.<sup>15</sup> In 2002, SAIC retained Gerard Denault to serve as the City-Time project's Deputy Program Manager.<sup>16</sup> Denault in turn retained Technodyne to fulfill the project's staffing needs.<sup>17</sup> The partnership quickly deteriorated into a kickback scheme wherein Technodyne unlawfully paid Denault for each hour a Technodyne affiliate performed work on the CityTime project.<sup>18</sup> The arrangement incentivized Denault both to employ more Technodyne workers than nec-

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<sup>8</sup> See Turk & Woody, *supra* note 2, at 960 (noting that the uncertainty created by this split will remain indeterminately).

<sup>9</sup> See *infra* notes 12–58 and accompanying text.

<sup>10</sup> See *infra* notes 59–85 and accompanying text.

<sup>11</sup> See *infra* notes 86–108 and accompanying text.

<sup>12</sup> See *infra* notes 15–30 and accompanying text.

<sup>13</sup> See *infra* notes 31–41 and accompanying text.

<sup>14</sup> See *infra* notes 42–58 and accompanying text.

<sup>15</sup> *SAIC*, 818 F.3d at 89. SAIC, now known as Leidos Holdings, Inc., provided its customers, predominantly government agencies, with defense-related services. *Id.* SAIC developed CityTime for use by numerous New York City agencies. *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* As part of that arrangement, Technodyne also illegally paid SAIC's Chief Systems Engineer, Carl Bell. *Id.* SAIC ultimately billed New York City approximately \$635 million for CityTime, far exceeding the project's initial cost estimate of \$63 million. *Id.* The \$635 million included costs from the kickback arrangement as well as those stemming from a contract amendment that made New York City liable for any cost overruns. *Id.*

essary and to exaggerate the number of hours required to complete the CityTime project.<sup>19</sup>

In late 2010, when SAIC caught on to the scheme, it put Denault on administrative leave and hired a law firm to investigate potential fraud in conjunction with SAIC's audit team.<sup>20</sup> On March 9, 2011, the audit team reported the results of its investigation to SAIC.<sup>21</sup> Despite the audit team's findings of impropriety, SAIC did not disclose any possible liability stemming from the CityTime project in its Annual Report on Form 10-K, filed on March 25, 2011.<sup>22</sup> SAIC only disclosed the existence of the criminal investigations in filings with the SEC after authorities filed federal criminal charges against Denault and others involved with CityTime.<sup>23</sup> In May 2011, SAIC fired Denault, and offered to repay \$2.5 million to New York City.<sup>24</sup>

On June 2, 2011, in a Current Report on Form 8-K, SAIC reported that government authorities were performing a criminal investigation into CityTime.<sup>25</sup> The 8-K further disclosed that there was potential further exposure, which was incapable of estimation at that time, should the investigation con-

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<sup>19</sup> *Id.*

<sup>20</sup> *Id.* Around this time, then-Mayor Michael Bloomberg, announced that New York City was considering whether to attempt to reclaim the funds paid out for the project. *Id.*

<sup>21</sup> *Id.* at 89. The results included information regarding the inappropriate timekeeping methods Denault utilized for the CityTime project. *Id.*

<sup>22</sup> *Id.* Pursuant to the disclosure obligations imposed by the federal securities laws, domestic companies registered with the SEC must file an annual report on Form 10-K, which offers "a comprehensive overview of the company's business and financial condition and includes audited financial statements." *Fast Answers: Form 10-K*, U.S. SEC. & EXCH. COMM'N (June 26, 2009), <https://www.sec.gov/fast-answers/answers-form10k.htm> [<https://perma.cc/6DF3-VLLX>]. Similarly, public companies must also file reports on Form 10-Q "for each of the first three fiscal quarters of the company's fiscal year." *Fast Answers: Form 10-Q*, U.S. SEC. & EXCH. COMM'N (Sept. 2, 2011), <https://www.sec.gov/fast-answers/answersform10q.htm> [<https://perma.cc/UDK9-UR4R>]. Forms 10-Q must include "unaudited financial statements and provide a continuing view of the company's financial position during the year." *Id.* Finally, public companies are also required to report certain material events on a regular basis. *Fast Answers: Form 8-K*, U.S. SEC. & EXCH. COMM'N (Aug. 10, 2012), <https://www.sec.gov/fast-answers/answersform8k.htm> [<https://perma.cc/H4UW-8SG8>]. The Current Report on Form 8-K is filed with the SEC "to announce major events that shareholders should know about." *Id.*; see also Jennifer S. Fan, *Regulating Unicorns: Disclosure and the New Private Economy*, 57 B.C. L. REV. 583, 606 (2016) (detailing the principal filing requirements imposed on public companies). In *SAIC*, Walter P. Havenstein, SAIC's Chief Executive Officer and Mark W. Sopp, SAIC's Chief Financial Officer, certified the 10-K's accuracy in its filing with the SEC. 818 F.3d at 89. Moreover, in an independent Annual Report to investors, SAIC publicized its "commitment to high standards of 'ethical performance and integrity,'" despite the fact that, by May 2011, many connected with the CityTime project were named in a federal criminal complaint alleging fraud. *Id.* (quoting Joint Appendix at 252, *SAIC*, 818 F.3d 85 (No. 14-4140-cv)).

<sup>23</sup> See *SAIC*, 818 F.3d at 89-90 (noting that SAIC finally informed the SEC and investors about the criminal investigation in a Form 8-K).

<sup>24</sup> *Id.* The \$2.5 million represented what Denault billed New York City as part of the fraudulent kickback scheme. *Id.* at 90.

<sup>25</sup> *Id.*; SAIC, Inc., Current Report (Form 8-K) (June 2, 2011).

clude negatively.<sup>26</sup> SAIC's Quarterly Report on Form 10-Q, filed on June 3, 2011, parroted those statements.<sup>27</sup> In a second 8-K, filed with the SEC on July 1, 2011, SAIC included a letter from then-Mayor Michael Bloomberg requesting that SAIC reimburse New York City for approximately \$600 million.<sup>28</sup> In March 2012, SAIC executed a deferred prosecution agreement with the federal government and New York City.<sup>29</sup> Pursuant to the terms of that agreement, SAIC agreed to cooperate in the pending investigation, to give up its claim for the \$40 million in amounts New York City still owed, and to repay approximately \$500.4 million.<sup>30</sup>

### B. SAIC's Procedural History

The plaintiffs, investors in SAIC, sued SAIC under Sections 10(b) and 20(a) of the Exchange Act.<sup>31</sup> The plaintiffs alleged that SAIC's SEC filings failed to disclose the company's possible exposure stemming from the City-Time project's fraudulent conduct or any related known trends or uncertainties, as required by Item 303 and Financial Accounting Standard No. 5 ("FAS 5").<sup>32</sup>

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<sup>26</sup> *SAIC*, 818 F.3d at 89–90; SAIC, Inc., Current Report (Form 8-K) (June 2, 2011). In that Form 8-K, SAIC reported that the United States Attorney's Office for the Southern District of New York and the New York City Department of Investigation were jointly investigating the CityTime project. *SAIC*, 818 F.3d at 90. The Form 8-K further reported that SAIC invoiced \$635 million for work on CityTime, that \$40 million in receivables were outstanding, that Denault had been arrested, and that SAIC had offered to reimburse \$2.5 million to the City. *Id.* Regarding possible further exposure, the Form 8-K stated, "there is a reasonable possibility of additional exposure to loss that is not currently estimable if there is an adverse outcome. An adverse outcome . . . could have a material adverse effect on the Company's consolidated financial position, results of operations and cash flows." SAIC, Inc., Exhibit 99.2 to Current Report (Form 8-K) (June 2, 2011). Therefore, the 8-K asserted that a negative resolution of the investigation would negatively impact SAIC's financial outlook. *Id.* In addition to filing the Form 8-K with the SEC, SAIC held a conference call with investors, during which SAIC leadership cited the Form 8-K as providing comprehensive information about the CityTime project and investigation. *SAIC*, 818 F.3d at 90.

<sup>27</sup> *SAIC*, 818 F.3d at 90.

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* In addition, SAIC acceded to distribute a "Statement of Responsibility," in which it would admit to defrauding the City. *Id.*

<sup>31</sup> *Id.* at 88; see Securities Exchange Act of 1934 §§ 10(b), 20(a), 15 U.S.C. §§ 78j(b), 78t(a) (2012). Section 10(b) is the Exchange Act's antifraud provision and Section 20(a) is the joint and several liability provision. §§ 10(b), 20(a). The plaintiffs also named SAIC's Chief Executive Officer and Chief Financial Officer as defendants, among others. *SAIC*, 818 F.3d at 88.

<sup>32</sup> *SAIC*, 818 F.3d at 91 (detailing the plaintiffs' claim that SAIC's March and June 2011 filings on Forms 10-K, 10-Q, and 8-K violated the disclosure requirements of FAS 5 and Item 303). Item 303 imposes particular disclosure obligations on companies filing Forms 10-K and 10-Q. 17 C.F.R. § 229.303(a)(3)(ii) (2018). FAS 5 establishes a framework for loss contingencies, requiring "the issuer to disclose a loss contingency when a loss is a 'reasonable possibility,' meaning that it is 'more than remote but less than likely.'" *SAIC*, 818 F.3d at 93 (quoting Financial Accounting Standards Board, Statement of Financial Accounting Standards No. 5, Accounting for Contingencies ¶¶ 3, 10 (1975)). The plaintiffs also alleged that SAIC's March 25, 2011 Form 10-K and the company's independent

The district court granted the defendants' motion to dismiss for all of the claims except the allegations of FAS 5 and Item 303 violations relating to the March, 2011 Form 10-K.<sup>33</sup> SAIC then filed a motion to reconsider the decision not to dismiss the FAS 5 and Item 303 claims, which the district court granted, dismissing the claims with prejudice.<sup>34</sup> The plaintiffs then moved to vacate or obtain relief from the judgment.<sup>35</sup> The plaintiffs also filed a motion for leave to file a proposed amended complaint.<sup>36</sup> The district court denied the plaintiffs' motions.<sup>37</sup> The plaintiffs appealed to the United States Court of Appeals for the Second Circuit, which vacated the judgment of the district court dismissing the FAS 5 and Item 303 claims.<sup>38</sup> The defendants then petitioned for writ of certiorari to the United States Supreme Court, which the Court granted.<sup>39</sup> The question presented was whether the Second Circuit incorrectly held that Item 303 creates a duty to disclose that, if violated, can establish liability under Section 10(b) and Rule 10b-5.<sup>40</sup> On the eve of the Supreme Court's hearing, the parties settled, precluding the Court from addressing the issue.<sup>41</sup>

### C. The Disclosure Requirements Mandated by the Federal Securities Laws

To effectuate the dual aims of the federal securities laws, Section 10(b) of the Exchange Act makes it unlawful to use any manipulative device, in connection with the purchase or sale of a security, in violation of the rules and

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Annual Report both contained misrepresentations and misstatements about SAIC's internal controls, its dedication to ethics, and its possible exposure due to the CityTime project. *SAIC*, 818 F.3d at 91.

<sup>33</sup> *SAIC*, 818 F.3d at 91. The District Court granted the plaintiffs leave to amend, within forty-five days, some of the dismissed claims, but the plaintiffs opted to forgo repleading them. *Id.*

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* Rule 59(e) of the Federal Rules of Civil Procedure provides, "[a] motion to alter or amend a judgment must be filed no later than 28 days after the entry of the judgment." FED. R. CIV. P. 59(e). Rule 60(b) states that "[on] motion and just terms, the court may relieve a party or its legal representative from a final judgment, order, or proceeding . . . ." FED. R. CIV. P. 60(b).

<sup>36</sup> *SAIC*, 818 F.3d at 91. Rule 15(a) governs the timing of the amendment of pleadings before trial. FED. R. CIV. P. 15(a).

<sup>37</sup> *SAIC*, 818 F.3d at 92. In denying Plaintiffs' motions, the district court concluded that amending the proposed second amended complaint would be fruitless. *Id.*

<sup>38</sup> *Id.* at 98. In vacating the judgment, the Second Circuit implicitly recognized that the violation of the duty to disclose imposed by Item 303 can constitute a violation of Section 10(b). *See id.* at 96, 98. (vacating the district court's dismissal of the plaintiffs' claims regarding Item 303 and FAS 5, thereby providing the plaintiffs leave to replead their fraud claims under Section 10(b)).

<sup>39</sup> *Leidos, Inc.*, 137 S. Ct. at 1396 (granting certiorari to review *SAIC*).

<sup>40</sup> Petition for Writ of Certiorari at i, *Leidos, Inc.*, 137 S. Ct. 1395, *dismissed*, No. 16-581 (Oct. 31, 2016).

<sup>41</sup> *See* Madelyn La France et al., *Securities Fraud*, 55 AM. CRIM. L. REV. 1677, 1682-83 (2018) ("the Supreme Court was to hear a case as to whether or not Item 303 of SEC Regulation S-K creates an affirmative duty to disclose, such that failure to do so creates an actionable fraud claim under Section 10(b), but the parties reached a last-minute settlement").

regulations promulgated by the SEC.<sup>42</sup> Under Section 10(b), the SEC promulgated Rule 10b-5, which provides, in relevant part, that it is unlawful to make any misstatement or omission of material fact in connection with the purchase or sale of a security.<sup>43</sup> To establish a violation of Section 10(b), a plaintiff must show that the defendant misstated or omitted a material fact with scienter in connection with the transaction of a security, which the plaintiff relied upon to the plaintiff's economic loss, causing injury to the plaintiff.<sup>44</sup> The Second Circuit has elaborated that, in that context, a misstatement or omission is a statement that misleads or conveys an incorrect impression of the factual circumstances.<sup>45</sup> Thus, a wide range of conduct can lead to liability under Section 10(b).<sup>46</sup> In *Basic, Inc. v. Levinson*, the Supreme Court held that the materiality of a misstatement or omission depends on an assessment of the amount of the potential loss in light of the company's operations discounted by the probability of the event's occurrence.<sup>47</sup>

By comparison, Item 303 imposes specific disclosure obligations on a company in its corporate filings with respect to the management's discussion and analysis of financial condition and results of operations.<sup>48</sup> Item 303 requires a company, in select corporate filings with the SEC, to articulate any

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<sup>42</sup> Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012); see *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 203–04 (1976) (stating that Section 10(b) was intended by its drafters to serve as a blanket provision enabling the SEC to prohibit all manipulative acts in the securities exchanges); *SEC v. Tambone*, 597 F.3d 436, 442 (1st Cir. 2010) (noting that Section 10(b) confers upon the SEC the authority to issue regulations thereunder); see, e.g., *Chadbourne & Parke*, 571 U.S. at 390 (confirming that the federal securities laws attempt to safeguard the exchanges from harmful conduct and thereby protect investors).

<sup>43</sup> 17 C.F.R. § 240.10b-5 (2018) (making it illegal “[t]o 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”).

<sup>44</sup> *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008) (citing *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341–42 (2005)). The Second Circuit requires plaintiffs to establish that the defendant: “(1) made misstatements or omissions of material fact, (2) with scienter, (3) in connection with the purchase or sale of securities, (4) upon which the plaintiff relied, and (5) that the plaintiff's reliance was the proximate cause of its injury.” *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 105 (2d Cir. 2007) (citing *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 172 (2d Cir. 2005)).

<sup>45</sup> See, e.g., *SEC v. Tex. Gulf Sulphur Co.*, 401 F.2d 833, 862 (2d Cir. 1968) (stating that representations made “in a manner reasonable calculated to influence the investing public” violate Section 10(b) and Rule 10b-5 “if such assertions are false or misleading or are so incomplete as to mislead”).

<sup>46</sup> See *La France et al.*, *supra* note 41, at 1682 (noting that any type of advertised deceit can lead to liability under Section 10(b)). Examples of the wide-ranging conduct that can lead to a violation of Section 10(b) include emails, advertisements, and impersonations. *Id.* at 1682 n.31.

<sup>47</sup> *Basic, Inc. v. Levinson*, 485 U.S. 224, 238 (1988) (quoting *Tex. Gulf Sulphur Co.*, 401 F.2d at 849) (“[M]ateriality ‘will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.’”).

<sup>48</sup> 17 C.F.R. § 229.303 (2018). Corporate filings bound by Item 303 include Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q. *S.A.I.C.*, 818 F.3d at 94 (quoting *Stratte-McClure*, 776 F.3d at 101).

trends or uncertainties known to company management which have or are reasonably expected to have a material effect on the company's financial performance.<sup>49</sup> In an interpretative release, the SEC clarified that the duty to disclose under Item 303 arises where management is aware of the trend or uncertainty and reasonably expects it to have a material effect on the company's financial stability.<sup>50</sup> Where such a trend or uncertainty is known, the SEC has instructed management to make two inquiries.<sup>51</sup> First, management must determine if the known trend or uncertainty is likely to transpire.<sup>52</sup> If it is not reasonably likely, no disclosure is required.<sup>53</sup> Second, if management cannot reach such a conclusion, it must objectively assess the implications of the known trend or uncertainty, assuming it will transpire, and disclose the trend or uncertainty if management establishes that an adverse impact on the company's financial stability is reasonably likely.<sup>54</sup>

Given the disclosure obligations imposed by Item 303, courts have grappled with the question of whether Item 303 creates a duty to disclose that, if violated, can establish a fraud claim under Section 10(b) of the Exchange Act.<sup>55</sup> In *Oran v. Stafford*, then-Judge Samuel Alito, writing for the Third Circuit, held that a violation of Item 303's duty to disclose does not inevitably lead to liability under Section 10(b).<sup>56</sup> Relying on *Oran*, the Ninth Circuit concluded in *In re NVIDIA Corp. Securities Litigation* that a violation of Item

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<sup>49</sup> 17 C.F.R. § 229.303(a)(3)(ii) (obligating SEC filers, in a section entitled management's discussion and analysis of financial condition and results of operations, to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations").

<sup>50</sup> Certain Investment Company Disclosures, 54 Fed. Reg. at 22,429 (providing that the duty to disclose "exists where a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial condition or results of operation").

<sup>51</sup> *Id.* at 22,430.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

<sup>54</sup> *Id.* In the second step of the inquiry, management "must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur." *Id.* In a footnote, the SEC specifies that this standard of disclosure governing Item 303 disclosure—reasonably likely to have a material effect—is different from the "probability/magnitude test for materiality . . . in *Basic, Inc. v. Levinson*, [which] is inapposite to Item 303 disclosure." *Id.* at 22,430 n.27.

<sup>55</sup> Compare *Stratte-McClure*, 776 F.3d at 102 (concluding that a violation of the duty to disclose under 303 can establish Section 10(b) liability), with *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1056 (concluding that a violation of Item 303's duty to disclose does not establish liability under Section 10(b) and Rule 10b-5).

<sup>56</sup> *Oran v. Stafford*, 226 F.3d 275, 288 (3d Cir. 2000) (holding that a violation of the duty to disclose imposed by Item 303 does not "automatically" establish liability under Section 10(b) and Rule 10b-5).

303's duty to disclose does not establish liability under Section 10(b).<sup>57</sup> In contrast, in *SAIC* and *Stratte-McClure*, the Second Circuit, also relying on *Oran*, concluded that, under some circumstances, violations of Item 303's duty to disclose can establish liability under Section 10(b).<sup>58</sup>

## II. SAIC'S LEGAL FRAMEWORK AND CONTEXT

The Second Circuit's decision in *Indiana Public Retirement Systems v. SAIC, Inc.* cements its rift with the Ninth Circuit over whether Item 303 creates a duty to disclose that, if violated, can constitute a violation of Section 10(b).<sup>59</sup> The Ninth Circuit has held that Item 303 does not create an affirmative duty to disclose that can establish a Section 10(b) securities fraud claim.<sup>60</sup> The Second Circuit has reached the opposite conclusion.<sup>61</sup> Despite their opposite conclusions, both circuits relied on the Third Circuit's *Oran v. Stafford* to reach their conclusions.<sup>62</sup> The split between the Second and Ninth Circuits is significant because those circuits hear more federal securities law cases than the rest of the circuits combined.<sup>63</sup> The divergence causes confusion for other circuits, lower courts, securities lawyers, and corporate filers; therefore clarity is needed.<sup>64</sup>

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<sup>57</sup> See *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1056 (relying on *Oran* to hold that Item 303 does not create a duty to disclose for purposes of establishing a violation of Section 10(b) and Rule 10b-5).

<sup>58</sup> See *Stratte-McClure*, 776 F.3d at 103–04 (reading *Oran* to be consistent with its conclusion that violations of Item 303's duty to disclose can, under some circumstances, violate Section 10(b)). To date, however, only the Second, Third, and Ninth Circuits have directly addressed the issue. *Id.*; *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1056; *Oran*, 226 F.3d at 288; see Petition for Writ of Certiorari, *supra* note 40, at 2 (arguing that the Second Circuit's holding in *SAIC* established a 2–1 circuit split between the circuits.).

<sup>59</sup> See *supra* note 55 and accompanying text.

<sup>60</sup> *Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.)*, 768 F.3d 1046, 1056 (9th Cir. 2014).

<sup>61</sup> See *Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 94 n.7 (2d Cir. 2016) (citing *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 102 (2d Cir. 2015)) (reaffirming the court's earlier conclusion that a violation of Item 303's duty to disclose can be actionable under Section 10(b)).

<sup>62</sup> Compare *Stratte-McClure*, 776 F.3d at 103–04 (interpreting *Oran* as compatible with the conclusion that a violation of Item 303's disclosure requirements can violate Section 10(b) and Rule 10b-5 when the omission is both material under *Basic, Inc. v. Levinson* and the plaintiff has established the remaining elements of the cause of action), with *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1054–56 (reading *Oran* as supporting the conclusion that the duty to disclose imposed by Item 303 does not support a claim under Section 10(b) and Rule 10b-5).

<sup>63</sup> Petition for Writ of Certiorari, *supra* note 40, at 1–2. See generally STANFORD LAW SCH., *Securities Class Action Clearinghouse*, <http://securities.stanford.edu/list-mode.html%22> [<https://perma.cc/A5FU-KGUZ>] (highlighting, through a database of class action securities lawsuits filed in the United States, that the Ninth and Second Circuits hear the majority of cases dealing with securities issues).

<sup>64</sup> Petition for Writ of Certiorari, *supra* note 40, at 10, 17–18 (noting that the Second and Ninth Circuits' diverging standards have generated problems of forum shopping and led to varying outcomes under what are intended to be uniform federal securities statutes); see *Stratte-McClure*, 776 F.3d at 102 (finding that failure to satisfy Item 303's disclosure requirements can establish Section

Section A of this Part discusses the Third Circuit's *Oran* decision, which the Second and Ninth Circuits relied upon in reaching their conclusions.<sup>65</sup> Section B provides an overview of the Second Circuit's reasoning in *SAIC*, and that court's conclusion that Item 303 creates an affirmative duty to disclose for purposes of a Section 10(b) claim.<sup>66</sup> Section C details the Ninth Circuit's holding in *Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Securities Litigation)* that a violation of the duty to disclose imposed by Item 303 does not constitute a violation of Section 10(b), and the underlying rationale of that decision.<sup>67</sup>

### A. The Third Circuit Leaves Unanswered the Question of Section 10(b) Liability for a Violation of Item 303

In *Oran*, the Third Circuit held that a violation of Item 303's duty to disclose does not necessarily constitute a violation of Section 10(b).<sup>68</sup> In so concluding, the court considered the standard applicable to Item 303 disclosure and its inconsistency with the standard governing Section 10(b) fraud actions.<sup>69</sup> The court reasoned that the two standards differ considerably, and therefore a violation of Item 303's disclosure requirements does not automatically establish liability under Section 10(b).<sup>70</sup> Accordingly, the court concluded that a violation of the disclosure requirements of Item 303 is not always a material omission under Section 10(b) and Rule 10b-5.<sup>71</sup> Thus, the Third Circuit did not decide whether a failure to disclose as required by Item 303 could, under some circumstances, establish liability under Section 10(b).<sup>72</sup>

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10(b) liability); *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1056 (concluding that failure to satisfy Item 303's disclosure requirements does not establish liability under Section 10(b) and Rule 10b-5).

<sup>65</sup> See *infra* notes 68–72 and accompanying text.

<sup>66</sup> See *infra* notes 73–80 and accompanying text.

<sup>67</sup> See *infra* notes 81–85 and accompanying text.

<sup>68</sup> *Oran v. Stafford*, 226 F.3d 275, 288 (3d Cir. 2000). In *Oran*, stockholders in American Home Products Corporation (“AHP”), brought suit against AHP and several officers and directors, alleging that AHP made material omissions and misrepresentations regarding the safety of two weight-loss drugs in light of accounts of significant side effects. *Id.* at 279. The United States District Court for the District of New Jersey granted the defendants' motion to dismiss, and the plaintiffs appealed. *Id.* at 281. The plaintiffs raised four arguments on appeal, one of which was that AHP violated Item 303, which could lead to liability under Section 10(b) and Rule 10b-5. *Id.*

<sup>69</sup> See *id.* at 287 (examining the disclosure required by Item 303 and comparing it to the disclosure obligations required to pursue a securities action under Section 10(b) and Rule 10b-5).

<sup>70</sup> See *id.* at 288 (explaining that the duty to disclose under Item 303 is much broader than the duty to disclose under Section 10(b) and Rule 10b-5). For a more detailed explanation of the differences between the two standards, see *infra* note 82 and accompanying text.

<sup>71</sup> *Oran*, 226 F.3d at 288.

<sup>72</sup> See *id.* (holding that a violation of Item 303 is not “automatically” a violation of Section 10(b)); see also *Stratte-McClure*, 776 F.3d at 103 (asserting that *Oran* insinuated, but did not decide, that under some circumstances a violation of Item 303 could lead to liability under Section 10(b) and Rule 10b-5); Lauren M. Mastronardi, Note, *Shining the Light a Little Brighter: Should Item 303 Serve as a Basis for Liability Under Rule 10b-5?*, 85 FORDHAM L. REV. 335, 362 (2016) (arguing that alt-

*B. The Second Circuit's Relies on Circuit Precedent in Deciding that an Item 303 Violation Can Constitute a Violation of Section 10(b)*

In *SAIC*, the Second Circuit built upon its earlier decision in *Stratte-McClure v. Morgan Stanley*, recognizing that the violation of Item 303 can, under certain circumstances, establish liability under Section 10(b).<sup>73</sup> In *Stratte-McClure*, the Second Circuit had held that Item 303 creates an affirmative duty to disclose that, if violated, can constitute a violation of the federal securities laws.<sup>74</sup> In so holding, the court relied on earlier courts that had recognized that the affirmative duty to disclose required to plead a Section 10(b) claim can flow from regulations mandating such disclosure.<sup>75</sup> The Second Circuit agreed with those courts, reasoning that omitting information required by a mandatory corporate filing could render the filing misleading in violation of Section 10(b).<sup>76</sup> Item 303's mandatory disclosures provide shareholders with insight into a company's financial performance, therefore the Second Circuit noted that the reasonable investor would assume that the lack of an Item 303 disclosure would denote that no known trends or uncertainties existed.<sup>77</sup> Since the court reasoned that the omission of known trends and uncertainties in violation of Item 303 can render the statement misleading, it concluded that Item 303

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though *Oran* identified the different standards of disclosure under Item 303 and Rule 10b-5, it did not describe the two standards as mutually exclusive).

<sup>73</sup> *SAIC*, 818 F.3d at 94 n.7. The Second Circuit recognized that a violation of Item 303 can establish liability under Section 10(b) by instructing the lower court to allow the plaintiffs to amend their Item 303 claims. *See id.* at 98 (vacating the district court's judgment regarding the Item 303 and FAS 5 claims and remanding "for further proceedings consistent with this opinion").

<sup>74</sup> *Stratte-McClure*, 776 F.3d at 101. The controversy in *Stratte-McClure* arose out of Morgan Stanley's losses resulting from the subprime mortgage crisis. *Id.* at 96. The plaintiffs, Morgan Stanley shareholders, initiated a class action lawsuit under Sections 10(b) and 20(a) of the Exchange Act. *Id.* The plaintiffs claimed that Morgan Stanley and various officers and ex-officers made unlawful misstatements and omissions of material facts in an attempt to suppress Morgan Stanley's losses from the crisis, causing significant financial injury to shareholders. *Id.*

<sup>75</sup> *Id.* at 102 (noting that prior decisions in the Second Circuit and other circuits had established that the regulations or statutes calling for disclosure could create a duty to disclose for purposes of Section 10(b)); *see, e.g.,* *Gallagher v. Abbott Labs.*, 269 F.3d 806, 808 (7th Cir. 2001) ("We do not have a system of continuous disclosure. Instead firms are entitled to keep silent (about good news as well as bad news) unless positive law creates a duty to disclose.") (internal citation omitted).

<sup>76</sup> *Stratte-McClure*, 776 F.3d at 102 (reasoning that it is proper for statutes or regulations requiring disclosure to establish Section 10(b)'s duty to disclose because omitting information in violation of such statutes or regulations would make the statement misleading in violation of Section 10(b) and Rule 10b-5); *see* 17 C.F.R. § 240.10b-5 (2018) (making unlawful the misstatement or omission of a material fact that, under the circumstances, were necessary to make the larger statements not misleading).

<sup>77</sup> *Stratte-McClure*, 776 F.3d at 102 (citing 17 C.F.R. § 229.303(a)(3)(ii) (2018)) (noting that "a reasonable investor would interpret the absence of an Item 303 disclosure to imply the nonexistence of 'known trends or uncertainties . . . that the registrant reasonably expects will have a material . . . unfavorable impact on . . . revenues or income from continuing operations'").

imposes a duty to disclose that, if violated, can establish liability under Section 10(b).<sup>78</sup>

The Second Circuit, however, recognized that a violation of the Item 303 disclosure requirement does not *per se* establish liability under Section 10(b) because Rule 10b-5 makes only material violations actionable under the statute.<sup>79</sup> Thus, in *Stratte-McClure*, the Second Circuit concluded that a violation of the duty to disclose imposed by Item 303 can constitute a violation of Section 10(b) only if the omitted information satisfies the materiality standard articulated by the Supreme Court in *Basic, Inc. v. Levinson*.<sup>80</sup>

### *C. The Ninth Circuit Concludes a Violation of Item 303's Duty to Disclose Does Not Constitute a Violation of Section 10(b)*

In contrast to the Second Circuit's conclusion, in *In re NVIDIA Corp. Securities Litigation* the Ninth Circuit held that Item 303 does not create a duty to disclose that is actionable under Section 10(b).<sup>81</sup> Relying on the reasoning of the Third Circuit's *Oran* opinion, the Ninth Circuit concluded that Item 303's

<sup>78</sup> See *id.* (“[O]mitting an item required to be disclosed [by Item 303] can render that financial statement misleading . . . . It follows that Item 303 imposes the type of duty to speak that can, in appropriate cases, give rise to liability under Section 10(b).”).

<sup>79</sup> See *id.* (citing 17 C.F.R. § 240.10b-5) (noting that failing to meet the disclosure obligations of Item 303 alone is insufficient to satisfy the Section 10(b) cause of action because Rule 10b-5 makes only ‘material’ omissions actionable.”). In *Basic, Inc. v. Levinson*, the Supreme Court concluded that a forward-looking statement is determined to be material by weighing the likelihood that the stated event will happen and the projected scale of the stated event given the entirety of the company's behavior. 485 U.S. 224, 238 (1988) (quoting SEC v. Tex. Gulf Sulfur Co., 401 F.2d 833, 849 (2d Cir. 1968)) (“[M]ateriality ‘will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.’”).

<sup>80</sup> *Stratte-McClure*, 776 F.3d at 103. To determine whether information omitted in violation of Item 303 satisfies the *Basic* materiality standard, a plaintiff must allege in the first instance that the defendant omitted information in violation of Item 303, thus demonstrating that the defendant had a duty to disclose. *Id.* Second, a plaintiff must demonstrate that the information was material under the *Basic* standard, due to the fact that Rule “10b-5 only makes unlawful an omission of ‘material information’ that is ‘necessary to make . . . statements made,’ . . . ‘not misleading.’” *Id.* (quoting *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44 (2011)). Lastly, as is required for all Section 10(b) claims, a plaintiff must also demonstrate “scienter, a ‘connection between the . . . omission and the purchase or sale of a security,’ reliance on the omission, and an economic loss caused by that reliance.” *Id.* (quoting *Levitt v. J.P. Morgan Sec., Inc.*, 710 F.3d 454, 465 (2d Cir. 2013)).

<sup>81</sup> *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1056. In *In re NVIDIA Corp. Securities Litigation*, the plaintiffs, investors in NVIDIA Corp., a public semiconductor company, brought suit against NVIDIA, alleging violations of the federal securities laws. *Id.* at 1048. In the spring of 2008, NVIDIA made disclosure to investors about defects in two of NVIDIA's products. *Id.* Shortly thereafter, NVIDIA disclosed to shareholders that it would be assuming a roughly \$200 million charge in order to cover the defects' associated costs. *Id.* In their complaint, the plaintiffs alleged that NVIDIA was aware it would be liable for the defects well in advance of its disclosures, and that NVIDIA should have disclosed the defects to shareholders in November 2007. *Id.* Given the lack of earlier disclosure, the plaintiffs claimed NVIDIA's statements to investors regarding its financial condition were misleading in violation of Section 10(b). *Id.*

disclosure obligations differ significantly from the materiality standard laid out in *Basic*.<sup>82</sup> The Ninth Circuit noted that the SEC expounded on this point, stating in an interpretative release that *Basic*'s standard is unsuitable for disclosure under Item 303.<sup>83</sup> Thus, because the two standards—materiality under Rule 10b-5 and the two-step inquiry under Item 303—are substantially different, the Ninth Circuit held that a violation of Item 303's disclosure requirements does not demonstrate that the disclosure is required under Section 10(b) and Rule 10b-5.<sup>84</sup> Consequently, the Ninth Circuit held that Item 303 does not establish a duty to disclose for purposes of Section 10(b).<sup>85</sup>

### III. THE SECOND CIRCUIT'S CORRECT CONCLUSION THAT A VIOLATION OF ITEM 303'S DUTY TO DISCLOSE CAN VIOLATE SECTION 10(B)

In *Indiana Public Retirement System v. SAIC, Inc.*, the Second Circuit, building off its earlier decision in *Stratte-McClure v. Morgan Stanley*, correctly recognized that a violation of Item 303's disclosure requirements can establish liability under Section 10(b).<sup>86</sup> Further, the Second Circuit correctly limited

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<sup>82</sup> *Id.* at 1054–55 (citing *Oran*, 226 F.3d at 288). Item 303 requires management to “[d]escribe [in corporate filings] any known trends or uncertainties that have had or that the registrant reasonably expects will have a material . . . impact on net sales or revenues or income from continuing operations.” 17 C.F.R. § 229.303(a)(3)(ii). In an interpretive release, the SEC further clarified this requirement by obligating management to perform a two-step analysis asking first if “the known trend, demand, commitment, event or uncertainty” is likely to occur. Certain Investment Company Disclosures, 54 Fed. Reg. 22,427, 22,430 (May 18, 1989). Disclosure is not required “[i]f management determines that it is not reasonably likely to occur.” *Id.* If management cannot make that determination, the second step requires management to assume the uncertainty will occur and “evaluate objectively the consequences” of such occurrence. *Id.* If “management determines that a material effect on the registrant’s financial condition or results of operations is not reasonably likely to occur” disclosure is not required. *Id.* By contrast, the materiality of forward-looking statements depends “upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.” *Basic*, 485 U.S. at 238 (quoting *Tex. Gulf Sulphur Co.*, 401 F.2d at 849). Thus, the Ninth Circuit reasoned that the disclosure required under Item 303 is much broader in scope than the disclosure required under the Supreme Court’s materiality standard in *Basic*. *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1055.

<sup>83</sup> *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1055 (pointing to the SEC’s instruction that the standard of materiality in *Basic* is not the standard of disclosure applicable to Item 303); see Certain Investment Company Disclosures, 54 Fed. Reg. at 22,430 n.27 (“[Item 303] mandates disclosure of specified forward-looking information, and specifies its own standard for disclosure—*i.e.*, reasonably likely to have a material effect. This specific standard governs the circumstances in which Item 303 requires disclosure. The [*Basic* materiality test] . . . is inapposite to Item 303 disclosure.”).

<sup>84</sup> *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1055 (citing *Oran*, 226 F.3d at 288) (reasoning that the two standards of disclosure are substantially different, therefore the violation of Item 303 does not establish a violation of Section 10(b) and Rule 10b-5).

<sup>85</sup> *Id.* at 1056 (holding that the violation of Item 303’s duty to disclose does not establish a violation of Section 10(b) and Rule 10b-5).

<sup>86</sup> See *Ind. Pub. Ret. Sys. v. SAIC, Inc.*, 818 F.3d 85, 94 n.7 (2d Cir. 2016) (reaffirming its holding in *Stratte-McClure*); *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 103 (2d Cir. 2015) (holding that failure to disclose under Item 303 can sometimes violate Section 10(b) and Rule 10b-5).

that holding to cases where the omitted information satisfies the Supreme Court's *Basic, Inc. v. Levinson* materiality standard.<sup>87</sup>

The Supreme Court has provided that, without a positive disclosure obligation, remaining silent does not violate Section 10(b) and Rule 10b-5.<sup>88</sup> The requisite duty to disclose arises from, among other sources, statutes or regulations calling for such disclosures.<sup>89</sup> As the Second Circuit properly noted, Item 303, as a regulation promulgated by the SEC, imposes upon SEC registrants such an affirmative duty to disclose.<sup>90</sup> Under Item 303, management is obligated to disclose a trend or uncertainty of which it is aware and that it expects will materially affect the company's operations.<sup>91</sup> Given this affirmative obligation, the Second Circuit properly reasoned that a violation of Item 303's duty to disclose can, under certain circumstances, constitute a violation of Section 10(b).<sup>92</sup> Stated plainly, the Second Circuit has persuasively reasoned, if the

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<sup>87</sup> See *SAIC*, 818 F.3d at 94 n.7 (reaffirming its holding in *Stratte-McClure* that failing to make a disclosure required by Item 303 can constitute a violation of Section 10(b) and Rule 10b-5 if the omitted information is material under *Basic* and the cause of action's remaining elements are established).

<sup>88</sup> See, e.g., *Basic, Inc. v. Levinson*, 485 U.S. 224, 239 n.17 (1988) ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5."). The disclosure regime mandated by the federal securities laws is not predicated upon continuous disclosure, but rather upon disclosure in light of a duty obligating such disclosures. See *Gallagher v. Abbott Labs.*, 269 F.3d 806, 808 (7th Cir. 2001) (noting that corporate filers are permitted not to make any disclosure unless affirmatively required to do so by law).

<sup>89</sup> See *Stratte-McClure*, 776 F.3d at 101 (quoting *Glazer v. Formica Corp.*, 964 F.2d 149, 157 (2d Cir. 1992)) (stating that the duty to disclose arises from, among other affirmative obligations, a "'statute or regulation requiring disclosure,' or a corporate statement that would otherwise be 'inaccurate, incomplete, or misleading'").

<sup>90</sup> 17 C.F.R. § 229.303(a)(3)(ii) (2018) (requiring companies to "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations"); see *SAIC*, 818 F.3d at 94 & n.7 (explaining the obligations imposed by Item 303); Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639, 1651 (2004) (stating that a duty to disclose exists where an omission would have the possibility to mislead and noting that there are certain trends or uncertainties about which shareholders would want to be informed).

<sup>91</sup> 17 C.F.R. § 229.303(a)(3)(ii). This duty to disclose is not unlimited, and is restricted to only those "trends or uncertainties" actually known to management. See *SAIC*, 818 F.3d at 95 (stating that Item 303 requires the disclosure of only those trends or uncertainties about which management is aware at the time of filing with the SEC). Under Item 303, that management should have been aware of a trend or uncertainty does not suffice. *Id.* In an interpretive release, the SEC has confirmed both that a duty to disclose exists and that it is limited to information actually known to management. See *Certain Investment Company Disclosures*, 54 Fed. Reg. at 22,429 (clarifying that the duty to disclose imposed by Item 303 extends to only those trends or uncertainties "presently known to management").

<sup>92</sup> See *Stratte-McClure*, 776 F.3d at 102 (noting that Item 303's duty to disclose can lead to liability under Section 10(b) in certain circumstances). *But see* *Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Sec. Litig.)*, 768 F.3d 1046, 1056 (9th Cir. 2014) (holding that Section 10(b) liability cannot be established by a violation of Item 303's duty to disclose).

information omitted in violation of Item 303 is material under *Basic*, Section 10(b) is violated.<sup>93</sup>

The federal securities laws seek both to regulate securities exchanges and to protect investors from market abuse and unfair practices.<sup>94</sup> Recognizing Item 303 as a duty to disclose for purposes of Section 10(b) liability will provide investor protection by requiring SEC registrants to disclose to investors those material trends or uncertainties known to management.<sup>95</sup> Item 303 disclosures provide investors the opportunity to assess the reporting company from the perspective of management.<sup>96</sup> In enabling investors to make informed investment decisions, this scheme achieves investor protection and thereby furthers Congress's intent in enacting the federal securities laws.<sup>97</sup>

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<sup>93</sup> See *Stratte-McClure*, 776 F.3d at 103 (concluding that a violation of Item 303's duty to disclose can only establish liability under Section 10(b) and Rule 10b-5 if the information is material under the *Basic* standard). A plaintiff must also sufficiently plead the other elements of the Section 10(b) cause of action. *Id.* at 104.

<sup>94</sup> See, e.g., *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 728 (1975) (highlighting that the Exchange Act is "an Act to provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes") (internal quotation omitted); see also *Mastronardi*, *supra* note 72, at 339 ("After the crash, Congress determined that abuses in the securities markets, such as fraud and deliberate manipulation of stock prices, were partially to blame. Thus, one of Congress's main priorities [in enacting the federal securities laws] was to find a way to protect vulnerable investors.").

<sup>95</sup> See *United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 849 (1975) (identifying investor protection and the regulation of the securities exchanges to reduce abusive behaviors as the underlying purposes of the federal securities laws); see also *Stratte-McClure*, 776 F.3d at 102 (providing that inadequate disclosure under Item 303 can establish liability under Section 10(b) if the omitted information is material under *Basic*). Failure to adequately disclose information under Item 303 will risk liability under Section 10(b). See Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012) (codifying the Exchange Act's antifraud provision).

<sup>96</sup> *Stratte-McClure*, 776 F.3d at 102 (stating that information disclosed pursuant to Item 303 "give investors an opportunity to look at the registrant through the eyes of management") (quoting *Certain Investment Company Disclosures*, 54 Fed. Reg. at 22,436).

<sup>97</sup> See *Mastronardi*, *supra* note 72, at 364 (noting that potential Section 10(b) liability incentivizes companies to comply with Item 303's disclosure requirements, thereby providing investors with meaningful information). The legislative history of the Exchange Act confirms that investor protection was one of Congress's priorities. H.R. REP. NO. 73-1383, at 2, 5 (1934) ("[T]his bill seeks to regulate the stock exchanges and the relationships of the investing public to corporations which invite public investment by listing on such exchanges . . . it [is] a condition of the very stability of . . . society that its rules of law and of business practice recognize and protect that ordinary citizen's dependent position."). In addition to achieving investor protection, the mandatory disclosure regime also increases market efficiency by requiring corporate filers to make available to the market larger volumes of truthful information about the state of their businesses. *Mastronardi*, *supra* note 72, at 343. Requiring public companies to disclose—fully and accurately—salient information about the securities they offer will enable individual investors to value an investment opportunity and "fend for themselves." See *Fan*, *supra* note 22, at 598–99 (quoting Steven L. Schwarcz, *Rethinking the Disclosure Paradigm in a World of Complexity*, 2004 U. ILL. L. REV. 1, 12) (articulating the underlying rationale of the federal securities laws' mandatory disclosure regime).

Opponents of this scheme argue that such an application would engulf investors with so much information that they would be unable to comprehend or identify critical information, thereby nullifying the efficacy of the disclosure obligation.<sup>98</sup> Contrary to that argument, the scheme would not inundate investors with information, because only material trends or uncertainties would need to be disclosed.<sup>99</sup> Moreover, Item 303 requires disclosure of only those unfavorable trends or uncertainties actually known to management, who are unlikely to speculate unnecessarily about such trends or uncertainties.<sup>100</sup> Allowing Item 303's affirmative duty to disclose to serve as the basis of a violation of Section 10(b) of the Exchange Act achieves superior investor protection and furthers the aims of the federal securities laws.<sup>101</sup>

The Ninth Circuit incorrectly concluded that an Item 303 violation can never constitute a violation of Section 10(b).<sup>102</sup> Furthermore, its reliance on the Third Circuit's *Oran* decision for that proposition was misplaced.<sup>103</sup> The Ninth Circuit suggested that *Oran* stood for the proposition that a violation of Item 303's disclosure requirements can never constitute a violation of Section 10(b).<sup>104</sup> In actuality, *Oran* implicitly recognized that a violation of Item 303 can, under certain circumstances, establish liability under Section 10(b).<sup>105</sup> In-

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<sup>98</sup> See Mastronardi, *supra* note 72, at 364 (discussing one counterargument to permitting violations of Item 303 to constitute violations of Section 10(b)—that, in response to such liability, companies will inundate investors with disclosure); see also Michael Greenstone, Paul Oyer & Annette Vissing-Jorgensen, *Mandated Disclosure, Stock Returns, and the 1964 Securities Acts Amendments*, 121 Q.J. ECON. 399, 404–05 (2006) (noting that mandatory disclosure regimes cause registrants to release an “inefficient[ ]” volume of information).

<sup>99</sup> See *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 44–45 (2011) (quoting 17 C.F.R. § 240.10b-5 (2018)) (explaining that Section 10(b) and Rule 10b-5 do not require the disclosure of all information, but rather only of material information that is required to render statements “in light of the circumstances under which they were made, not misleading”); see also Mastronardi, *supra* note 72, at 356 (describing Item 303's “intrinsic safeguards” that will prevent investors from being inundated with information).

<sup>100</sup> 17 C.F.R. § 229.303(a)(3)(ii); see Mastronardi, *supra* note 72, at 364 (noting that companies will not strive to provide more than the bare minimum of information required under Item 303).

<sup>101</sup> See *Superintendent of Ins. of N.Y. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971) (interpreting Section 10(b) as an intent by Congress to prohibit all manner of deception in securities transactions); see also Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 941–42 (1998) (“One of the most cited and intuitive goals of the securities laws is the protection of investors . . . Securities regulation, therefore, may play a role in forcing companies to provide information truthfully to investors.”).

<sup>102</sup> See *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1054 (holding that a violation of the duty to disclose imposed by Item 303 does not establish liability under Section 10(b) and Rule 10b-5).

<sup>103</sup> See *Stratte-McClure*, 776 F.3d at 103 (criticizing the Ninth Circuit for misinterpreting *Oran*).

<sup>104</sup> See *In re NVIDIA Corp. Sec. Litig.*, 768 F.3d at 1054–56 (relying on *Oran* to hold that a violation of the duty to disclose imposed by Item 303 cannot constitute a violation of Section 10(b)). *But see Stratte-McClure*, 776 F.3d at 103 (critiquing the Ninth Circuit's mischaracterization of *Oran*).

<sup>105</sup> *Oran v. Stafford*, 226 F.3d 275, 288 (3d Cir. 2000) (holding that the violation of the duty to disclose imposed by Item 303 does not “automatically” establish liability under Rule 10b-5). In *Stratte-McClure v. Morgan Stanley*, in concluding that Item 303 imposes a duty to disclose that can establish the basis of a violation of Section 10(b), the Second Circuit addressed its explicit disagreement

deed, subsequent courts have adopted this less restrictive interpretation of *Oran*.<sup>106</sup>

Moreover, rendering a violation of Item 303 incapable of establishing a violation of Section 10(b) would frustrate the goals of the federal securities laws by exposing investors to a greater risk of abuse without any recourse in the law.<sup>107</sup> Accordingly, other circuits and district courts should follow the Second Circuit's approach, and recognize that a violation of the duty to disclose mandated by Item 303 can, under the correct circumstances, lead to liability under Section 10(b).<sup>108</sup>

## CONCLUSION

In *Indiana Public Retirement Systems v. SAIC, Inc.*, the Second Circuit expanded on its earlier decision in *Stratte-McClure v. Morgan Stanley*, and recognized that Item 303 creates a duty to disclose that, if violated, can constitute a violation of Section 10(b) of the Securities Exchange Act of 1934. The Second Circuit correctly recognized that a violation of Item 303 can establish

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with the Ninth Circuit. 776 F.3d at 103–04. The Second Circuit principally disagreed with the Ninth's Circuit's characterization of *Oran*. See *id.* at 103 (criticizing the Ninth Circuit for relying on *Oran* to hold that violations of Item 303 do not constitute violations of Section 10(b) and Rule 10b-5). The Second Circuit interpreted *Oran* as having left open the possibility that a violation of Item 303 could, under certain circumstances, establish liability under Section 10(b). *Id.* ("Contrary to the Ninth Circuit's implication that *Oran* compels a conclusion that Item 303 violations are never actionable under 10b-5, *Oran* actually suggested, without deciding, that in certain instances a violation of Item 303 could give rise to a material 10b-5 omission.").

<sup>106</sup> See SEC v. Conaway, 698 F. Supp. 2d 771, 839 (E.D. Mich. 2010) (interpreting *Oran* as excluding from liability under 10(b) those violations of the Item 303 duty to disclose that are not material under *Basic*). Furthermore, the United States District Court for the Eastern District of Michigan reasoned that, under *Oran*, Item 303 liability under Section 10(b) could be restricted to those instances in which 1) disclosure is made as required by Item 303, 2) omitted information required by Item 303 is material under *Basic*, and 3) the omitted information renders the disclosure misleading given the circumstances. *Id.* at 839 & n.57. The Eastern District of Michigan also noted that the independent showing required by Section 10(b) missing in *Oran* was that the alleged omissions in *Oran* were not material, hence defendant American Home Products Corp. had not made any *material* misstatement. *Id.* at 839 (emphasis added) (citing *Oran*, 226 F.3d at 288). Another court to adopt this more permissive view of *Oran* is the United States District Court for the District of Minnesota. See *Beaver Cty. Emps.' Ret. Fund v. Tile Shop Holdings, Inc.*, 94 F. Supp. 3d 1035, 1047 (D. Minn. 2015) (viewing the Second Circuit's reasoning in *Stratte-McClure* as persuasive and adopting a more relaxed view of *Oran*). See generally Matthew Ady, *Living in a Material World: Does a Violation of Item 303 of Regulation S-K Satisfy the Materiality Element in a Rule 10b-5 Cause of Action?*, 17 WAKE FOREST J. BUS. & INTEL. PROP. L. 401, 424–25 (2017) (discussing courts that have adopted a more permissive view of *Oran*).

<sup>107</sup> See Ady, *supra* note 106, at 422–23 ("Stated plainly, the *NVIDIA* ruling effectively rendered Item 303 violations immune to Rule 10b-5. Stated even more plainly, if defendants could show that the omission was in violation of Item 303, then the omission could not qualify as material under Rule 10b-5."); Mastronardi, *supra* note 72, at 339 (citing investor protection as one of Congress's main concerns in enacting the federal securities laws).

<sup>108</sup> See *supra* note 87 and accompanying text.

liability under Section 10(b) only when the allegedly omitted information satisfies the material standard under the Supreme Court's *Basic, Inc. v. Levinson* decision, and otherwise demonstrates the cause of action's remaining elements. In so holding, the Second Circuit accurately construed the underlying statute and regulation, adhered to earlier jurisprudence, and furthered the aims of the federal securities laws. By contrast, the Ninth Circuit incorrectly reasoned, in *Cohen v. NVIDIA Corp. (In re NVIDIA Corp. Securities Litigation)*, that an Item 303 violation cannot constitute a violation of Section 10(b). Despite the Supreme Court's grant of certiorari in *SAIC*, an eleventh-hour settlement between the parties precluded the Supreme Court from resolving the split. Although future reviewing courts should follow the Second Circuit's approach, pending a resolution of the issue by the Supreme Court, confusion remains.

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