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Securities Litigation Alert

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Supreme Court clarifies scope of Rule 10b-5(b) liability

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The Supreme Court in *Macquarie Infrastructure Corp. v. Moab Partners* unanimously narrows 10b-5 liability and removes liability based on pure omissions.

What's the impact?

- The Court raises the bar on plaintiffs seeking to bring omissions claims without accompanying affirmative misleading statements.
- By requiring plaintiffs to allege specific affirmative statements rendered misleading by omitting material information, plaintiffs may have more difficulty surviving motions to dismiss by defendants.
- The case will very likely cause a shift from 10b-5(b) cases premised on pure omissions claims to affirmative misrepresentations or half-truth theories.

In a rare unanimous decision with significant implications for securities litigation, on April 12, 2024, in *Macquarie Infrastructure Corp. v. Moab Partners*,[i] a unanimous Supreme Court clarified the boundaries of liability under Rule 10b-5(b) by deeming pure omissions, i.e., silence, inactionable under the rule even if a statute or regulation created a duty to disclose.[ii]

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Prior Federal Court New York rulings regarding pure omissions from disclosure under Regulation S-K

Macquarie Infrastructure Corporation (Macquarie), the defendant-petitioner, owned a subsidiary that operated terminals storing bulk liquid commodities. One of the commodities stored is No. 6 fuel oil, which has a sulfur content close to 3%. In 2016, the International Maritime Organization (IMO) adopted a regulation called IMO 2020, which capped the sulfur content of fuel oil used in shipping at 0.5% by 2020. Macquarie did not disclose the impact of IMO 2020 in its public offering documents. In 2018, Macquarie announced a decrease in storage contracts due to the decline in the No. 6 fuel oil market, resulting in a 41% drop in its stock price.

Moab Partners, L.P. (Moab), a financial firm and the plaintiff-respondent, filed suit in the United States District Court for the Southern District of New York, alleging that Macquarie violated Rule 10b-5(b) by failing to disclose information about a regulation (IMO 2020) that would impact its business. Moab argued that Macquarie had a duty to disclose under Item 303 of SEC Regulation S–K, which requires companies to disclose known trends or uncertainties that have had or are reasonably likely to have a material favorable or unfavorable impact on net sales, revenues, or income from continuing operations in periodic filings with the SEC. Moab alleged that Macquarie's failure to disclose the impact of IMO 2020 rendered its statements misleading.

The District Court dismissed Moab's Complaint, and the Second Circuit Court of Appeals reversed. Concluding that Moab's allegations regarding the material effect of IMO 2020 gave rise to a duty to disclose under Item 303, the Second Circuit held that Macquarie's violation of Item 303 alone could sustain Moab's claim under Rule 10b–5. Macquarie then sought review from the Supreme Court of the United States, which granted certiorari.

Supreme Court's decision in *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*

In *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, the Supreme Court (Sotomayor, J.) addressed the question whether pure omissions, i.e., the failure to disclose information that does not render any "statements made" misleading, can be actionable under Rule 10b-5(b) of the Securities Exchange Act of 1934.[iii] In a unanimous decision that resolved a split among the Circuit Courts, the Court held that "pure omissions," are not actionable under Rule 10b-5(b), even where there is a duty to disclose the omitted information under Item 303.[iv] Rule 10b-5(b) prohibits making untrue statements of material facts while omitting material facts necessary to make the statements not misleading. The Court concluded that the Rule only prohibits half-truths, which are representations that state the truth but omit critical qualifying information. Pure omissions, on the other hand, occur when a speaker says nothing without any special significance to that silence. The Court determined that Rule 10b-5(b) only requires the disclosure of information necessary to ensure that statements already made are clear and complete.

The Court analyzed Rule 10b-5(b)'s language and statutory context. The Court compared Rule 10b-5(b) to Section 11(a) of the Securities Act of 1933, which explicitly creates liability for failure to speak. It reasoned that the absence of similar language in Rule 10b-5(b) and Section 10(b) indicated that "logically and by [the] plain text" of the Rule, silence alone, without some affirmative statement, which is rendered misleading by that silence, is not within the scope of Rule 10b-5(b). The Court reasoned that a duty to disclose does not automatically render silence misleading. The Court noted that private parties can still bring claims based on Item 303 violations that create misleading "half-truths" and that the SEC itself can police violations of Rule 303.

What should businesses and investors consider after *Macquarie*?

In a decision with significant implications for securities litigation, the Supreme Court resolved a Circuit split and narrowed the scope of Rule 10b-5(b) liability by excluding pure omissions from its reach. At least in the Second Circuit, the opposite result has been the rule for at least a decade.[v] This removes one tool from plaintiffs' 10b-5(b) arsenal by precluding claims based solely on silence. Instead, the Court raised the bar on plaintiffs by mandating that plaintiffs seeking to establish 10b-5(b) liability by omissions must also identify affirmative statements that the omission of material information renders misleading.

But what is the difference between a pure omission and a half-truth? The Court provides the simplistic example of "the difference between a child not telling his parents he ate a whole cake [pure omission] and telling them he had dessert [half-truth]."[vi] Most cases, however, are not likely to be so straightforward. For example, most public companies will address important issues facing them in the required Management Discussion and Analysis disclosures, at least to some degree. Whether such a discussion sufficiently broaches a particular subject that a plaintiff might assert was omitted so as to render the discussion a "half-truth" may, in many cases, be debatable.

Moreover, the Court clarified the duty to disclose under Rule 10b-5, confirming that a duty to disclose under Item 303 alone does not render silence misleading; rather, silence is actionable only if the omission renders an affirmative statement made misleading. The decision will undoubtedly impact how omission or half-truth cases are pleaded and evaluated in the future, as plaintiffs now must allege specific affirmative statements and explain how the omission of material information rendered the affirmative statements misleading. While the Court limited Rule 10b-5(b) application, the need remains for robust reporting practice to, among other things, mitigate potential litigation exposure. Companies, importantly, must still disclose known trends or uncertainties that could materially impact their financials, pursuant to Item 303 of SEC Regulation S-K, and the Court included a reminder in its opinion that the SEC can investigate violations of regulations, including Item 303.

While the decision clarified the rule for "pure omissions," what the Court did not decide is also notable. The Court granted certiorari to address the Second Circuit's pure omission analysis, not its half-truth analysis. It leaves open to the lower courts what it calls "tangential" issues, including what constitutes "statements made," when a half-truth is misleading, or whether pure omissions are actionable under Rules 10b-5(a) and 10b-5(c).

The full reach and impact of *Macquarie* will become clearer as lower courts and litigants interpret and apply this decision's reasoning to future securities litigation cases. Nixon Peabody's attorneys regularly counsel companies and their officers and directors on strategies to minimize the risk of litigation—and if litigation is unavoidable, we prioritize practical and efficient resolution.

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[i] *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, No. 22-1165, 2024 U.S. LEXIS 1575, 601 U.S. ____ (Apr. 12, 2024).

[ii] 2024 U.S. LEXIS 1575, at *10.

[iii] *Id.*, at *12.

[iv] *Id.*, at *10.

[v] *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94, 100 (2d Cir. 2015).

[vi] 2024 U.S. LEXIS 1575, at *10.