Capital Markets Alert

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After the Supreme Court's *Macquarie* Decision, are Public Companies Off the Hook for their MD&A Trends Disclosures?

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On April 12, 2024, the Supreme Court unanimously held in *Macquarie Infrastructure Corporation v. Moab Partners* that the pure omission of certain public disclosures required by the SEC's rules cannot form the basis of a private action under Rule 10b-5 under the Securities Exchange Act of 1934 (see also our SCOTUS Term in Review alert here). The decision puts to rest, for now, a series of claims attempting to hold public companies liable for the mere failure to describe in their Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) certain "known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations" as required by Item 303 of Regulation S-K.

Liability under Rule 10b-5 for Failure to Make Required MD&A Disclosures

Companies are potentially liable to investors for their public disclosures under Rule 10b-5, which 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*."

In *Macquarie*, the plaintiffs alleged that Macquarie failed to disclose known trends and uncertainties under Item 303 of Regulation S-K when it failed to disclose the adoption of a United Nations regulation capping the sulfur content of fuel oil held in storage facilities of a Macquarie subsidiary. Later, Macquarie's stock price fell significantly, following announcement of a decline in its storage business as a result of declines in the market of fuel oil affected by the regulation. Plaintiffs claimed that the omission to disclose information required by Item 303 itself was an omission that supported a claim under Rule 10b-5.

The Court found that the allegation of the omission alone does not support a claim under Rule 10b-5(b). Reversing the Second Circuit, the Court held that Rule 10b-5(b) "covers half-truths, not pure omissions" because it "requires identifying affirmative assertions (i.e., 'statements made') before determining if other facts are needed to make those statements 'not misleading.'" Thus, "[t]he failure to disclose information required by Item 303 can support a Rule 10b-5(b) claim only if the omission renders affirmative statements made misleading."

Are Public Companies Off the Hook?

In the wake of *Macquarie,* companies may be asking themselves whether they should be less concerned about providing required MD&A disclosures of known trends and uncertainties. In short, the answer is no. The *Macquarie* decision is a narrow one—it only eliminates a source of potential liability from a private action for the pure omission of forward-looking information about known trends and uncertainties. As discussed below, the failure to provide that information still creates significant exposure.

A Brief Refresher

The SEC has for decades focused on the importance of MD&A disclosures regarding known trends and uncertainties. These disclosures were the focus of the SEC's landmark MD&A Interpretive Release in 1989[1] and again in its 2020 rulemaking.[2]

Under SEC rules and guidance, companies must describe in their MD&A "any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations."[3] Companies are also required to identify "any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way"[4] and describe "any known material trends, favorable or unfavorable, in the registrant's capital resources."[5]

> As the SEC stated in the MD&A Interpretive Release:
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> Required disclosure is based on currently known trends, events, and uncertainties that are reasonably expected to have material effects, such as: A reduction in the registrant's product prices; erosion in the registrant's market share; changes in insurance coverage; or the likely non-renewal of a material contract. In contrast, optional forward-looking disclosure involves anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty.

To comply, companies should first consider whether a particular known trend or uncertainty is likely to come to fruition. If the happening of a known trend or uncertainty is remote, the company is not required to disclose it, so that security holders are not thereby overwhelmed with trivial information.[6]

If the happening of a known trend or uncertainty is likely, or if management cannot determine the likelihood, then the company must determine if the information is material in its process of determining whether to disclose.[7] Under the Supreme Court's standard, information is "material" if a reasonable investor would consider its omission as significantly altering the total mix of information made available in the company's disclosures.[8]

The Importance of Continuing to Focus on MD&A Disclosures

There are several reasons why companies should continue to focus on providing required disclosures of known trends and uncertainties. First, although the Supreme Court made a distinction between a pure omission and an omission that renders an affirmative statement misleading, in many cases, this is a distinction without a difference.

As the Court itself stated: "For one thing, private parties remain free to bring claims based on Item 303 violations that create misleading half-truths." A half-truth by its nature is an affirmative statement that may be literally accurate, but it is nonetheless misleading due to the failure to provide additional qualifying information. "In other words, the difference between a pure omission and a half-truth is the difference between a child not telling his parents he ate a whole cake and telling them he had dessert."

So following *Macquarie,* a claim that was once asserted as a pure omission of required SEC disclosure may instead be recast as a claim that other affirmative statements in the disclosure were rendered misleading by such omission. The practical result is that companies may continue to face litigation and liability exposure as a result of such omission.

For instance, consider the SEC's examples of currently known trends and uncertainties that may require disclosure in the MD&A, such as a reduction in the company's prices, an erosion in its market share and the likely non-renewal of a material contract. It would seem that a plaintiff in such cases would seek to identify affirmative statements in a company's public disclosures that were rendered misleading (i.e. "half-truths") as result of the failure to disclose the known trend or uncertainty. For example, if a company makes statements regarding the impact on revenues of a material contract, knowing that the material contract is not likely to be renewed, a plaintiff might argue that these statements are actionable "half-truths" under Rule 10b-5 if the company omits to disclose the potential non-renewal of that contract.

Even in *Macquarie* itself, the plaintiff identified in its brief affirmative statements in Macquarie's disclosures that it believed were actionable half-truths. The Court did not address whether any of these past disclosures were actionable. Instead, the Court only purported to answer the question certified to it as to: "Whether . . . a failure to make a disclosure required under Item 303 can support a private claim under Section 10(b), *even in the absence of an otherwise-misleading statement*." So it is conceivable that the plaintiff may continue to assert that past disclosures relating to Macquarie's oil storage business were rendered misleading as a result of Macquarie's failure to disclose the United Nations regulation impacting its business.

With the possibility that omissions of required SEC disclosures may still be asserted in Rule 10b-5 actions to identify other disclosures that were rendered misleading, companies should continue to focus on these disclosure standards. The same may be said for private companies whose disclosures are subject to potential Rule 10b-5 liability or for SEC exempt offerings, such as under Rule 144A, where Rule 10b-5 is the primary source of private liability. While the SEC's disclosure rules are not directly applicable in such cases, the SEC's views as to what types of information it considers material are certainly instructive.

Second, even if Rule 10b-5 does not provide a private right of action for a pure omission, public companies may be subject to potential liability under Section 11 of the Securities Act of 1933. Under Section 11 companies can be found strictly liable for material omissions of information "required" to be included in registration statements. In fact, in *Macquarie*, the Court highlighted that Congress already imposes liability for pure omissions in Section 11(a) of the Securities Act of 1933, and Rule 10b-5(b) does not share similar language.

Finally, even if there is no private right of action as a result of the *Macquarie* decision, the SEC can still bring its own action. The SEC is empowered to investigate violations of any provision of the Exchange Act. The Exchange Act, in turn, requires companies to file its reports in accordance with SEC rules and regulations. Thus, the omission of information required to be disclosed in the MD&A may result in an SEC enforcement action, even if no private right of action is available.

As a result of its limited scope and the other avenues of liability that remain, companies should not be relaxing their MD&A disclosures in the aftermath of the Supreme Court's *Macquarie* decision. In fact, given the SEC's focus, if a company is not undertaking the exercise of evaluating potential trends and uncertainties in connection with its quarterly preparation of its MD&A, now would be a good time to start.

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[1] SEC Release No. 33-6835 (May 18, 1989) (“MD&A Interpretive Release”).

[2] SEC Release No. 33-10890 (November 19, 2020) (“MD&A Adopting Relase”).

[3] Item 303(b)(2)(ii).

[4] Item 303(b)(1)(i).

[5] Item 303(b)(2)(ii).

[6] MD&A Adopting Release at 47. See also *Matrixx Initiatives, Inc. v. Siracusano*, 131 U.S. 1309, 1318 (2011).

[7] MD&A Adopting Release at 47.

[8] *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976).