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The *Leidos* Mixup and the Misunderstood Duty to Disclose in Securities Law

Matthew C. Turk & Karen E. Woody*

Abstract

This Article concerns the recent Supreme Court case, Leidos, Inc. v. Indiana Public Retirement System *(*Leidos*), and examines the broader issues that it raised for securities law. The consensus among scholars and practitioners is that* Leidos *presented a direct conflict among the circuit courts over a core question of securities law—when a failure to comply with the SEC's disclosure requirements can constitute fraud under Rule 10b-5. This Article provides a much different interpretation of the case. It begins by demonstrating that the circuit split which is presumed to have brought* Leidos *to the Supreme Court does not in fact exist. It then shows that, rather than being riddled with disagreement, the leading judicial analysis in this area of the law instead reflects a shared set of misconceptions about how the securities regulation architecture works.*

By unraveling the underlying sources of the Leidos *mix-up, this Article makes three contributions. First, it identifies overlooked aspects of the disclosure rules at issue in* Leidos*, and provides a novel analysis of how the case should have been decided. Second, it explains how errors in leading interpretations of the legal authorities implicated in* Leidos *carry over to other prominent portions of the regulatory framework, namely Sections 11 and 12 of the 1933 Securities Act. Third, it demonstrates that a central yet*

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ill-defined securities doctrine—the duty to disclose—functions primarily to obscure rather than clarify the legal questions at issue in disclosure fraud claims. Taken together, these points suggest that Leidos *was a more unusual case than has been appreciated, and stands at a remarkable confluence of legal and scholarly confusions, many of which implicate fundamental principles of securities law.*

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I. Introduction

For its October 2017 term, the U.S. Supreme Court granted certiorari in the case of *Leidos, Inc. v. Indiana Public Retirement System*[1] (*Leidos*), and thereby put itself on a course to address some of the most complex yet fundamental issues in securities regulation.[2] In securities law jargon, the specific question presented in *Leidos* was whether a regulation issued by the Securities and Exchange Commission (SEC), Item 303 of Regulation S-K (Item 303), creates a duty to disclose that is actionable under the prohibition against securities fraud set forth in Section 10(b) of the Securities Exchange Act of 1934 (the 1934 Exchange Act) and the related Rule 10b-5.[3] Stated more simply, the Court was asked to decide whether failure to comply with a disclosure mandate that is expressly stated in the SEC's rules can constitute fraud.[4] This is no small matter, given that corporate

1. Ind. Pub. Ret. Sys. v. SAIC, Inc., 818 F.3d 85 (2d Cir. 2016) (Lohier, J.), *cert. granted sub nom.* Leidos, Inc. v. Ind. Pub. Ret. Sys., 137 S. Ct. 1395 (2017) (No. 16-581) [hereinafter Lohier Op.].

2. *See id.* at 88 (setting forth the four securities issues addressed by the Second Circuit).

3. *See* Petition for Writ of Certiorari at i, Leidos, Inc. v. Ind. Pub. Ret. Sys., No. 16-581 (U.S. Oct. 31, 2016) [hereinafter *Leidos* Cert. Pet.] (posing the question for certiorari and noting that the Second Circuit's holding directly conflicted with the rulings of the Third and Ninth Circuits); *see also* 17 C.F.R. § 229.303 (2017) (setting forth regulations for the discussion and analysis of financial conditions by management and the results of operations); 15 U.S.C. § 78j (2012) (codifying Section 10(b)); 17 C.F.R. § 240.10b-5 (codifying Rule 10b-5).

4. *See Leidos* Cert. Pet., *supra* note 3, at i ("The question presented is: Whether the Second Circuit erred in holding—in direct conflict with the decisions

disclosures to investors have been the cornerstone of modern securities regulation since they were established in the 1930s,[5] and Item 303 in particular concerns one of the more important categories of information that public companies are called upon to produce: an overview of uncertainties facing a company's financial future, known as "Management's Discussion and Analysis" (MD&A).[6] The controversies raised by *Leidos* will not be resolved through any statement by the Court, however, and remain open indefinitely as a doctrinal matter, due to a settlement of the case that was announced by the parties on the eve of oral argument.[7]

of the Third and Ninth Circuits—that Item 303 of SEC Regulation S-K creates a duty to disclose that is actionable under Section 10(b) . . . and SEC Rule 10b-5.").

5. *See* JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET 39–40 (3d ed. 2003) (noting the need for disclosure of data by firms involved in the securities markets following the stock market crash of the Great Depression). *See generally* James M. Landis, *The Legislative History of the Securities Act of 1933*, 28 GEO. WASH. L. REV. 29 (1959) (discussing the origins and legislative history of the Securities Act of 1933); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197 (1999) (discussing the SEC and the need for expanded social disclosure requirements for public reporting companies in order to further social and financial transparency).

6. *See generally* Denise Voigt Crawford & Dean Galaro, *A Rule 10b-5 Private Right of Action for MD&A Violations?*, 43 SEC. REG. L.J. 1 (2015) (discussing "the use of Item 303 violations as a basis for a private cause of action under Rule 10b-5"); Mark S. Croft, *MD&A: The Tightrope of Disclosure*, 45 S.C. L. REV. 477 (1994) (considering MD&A disclosure requirements and various issues that have arisen in the requirements' application); Eric R. Harper, *Unveiling Management's Crystal Ball*, 77 LA. L. REV. 879 (2017) (discussing the history and various applications of the Exchange Act, Rule 10b-5, and Item 303); 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 (2016) (discussing the split between the Second and Ninth Circuits concerning the disclosure requirement of Item 303 and liability under Section 10(b) and Rule 10b-5); Brian Neach, Note, *Item 303's Role in Private Causes of Action Under the Federal Securities Laws*, 76 NOTRE DAME L. REV. 741 (2001) (noting the uncertainty concerning the application of Item 303 violations in private causes of actions and presenting a standard of review for such allegations in securities cases); Suzanne J. Romajas, *The Duty to Disclose Forward-Looking Information: A Look at the Future of MD&A*, 61 FORDHAM L. REV. S245 (1993) (discussing the differing approaches that the SEC and courts have taken concerning the disclosure of forward-looking information).

7. *See generally* Leidos, Inc. v. Ind. Pub. Ret. Sys., No. 16-581, 2017 WL 4622142 (U.S. Oct. 17, 2017) (stating that the proceedings are held "in abeyance"). If the settlement is not approved by the Southern District of New York, *Leidos* will be back on the Supreme Court's docket for the October 2018 term.

Leidos arose before the Court due to an intensifying clash between the Second Circuit and Ninth Circuit—the two federal appellate courts that together handle more securities cases than all other circuits combined.[8] The conflict first materialized in a 2015 decision, *Stratte-McClure v. Morgan Stanley*[9] (*Stratte-McClure*), in which the Second Circuit declared that its interpretation of the relationship between Item 303 and Section 10(b) was "at odds" with a Ninth Circuit case from the prior year, *In re NVIDIA Corporate Securities Litigation*[10] (*NVIDIA*).[11] When the Second Circuit decided *Leidos* a year later, it closely followed the reasoning set forth in *Stratte-McClure*.[12] *Leidos* is therefore perceived as escalating a preexisting dispute among the federal appellate courts,[13] and, as the *Leidos* plaintiff's successful petition for certiorari (Cert. Petition) states, introduced "a deep split of

8. *See Leidos* Cert. Pet., *supra* note 3, at 1–2 (noting that "[t]he Second and Ninth Circuits, which see more federal securities cases than the rest of the circuits combined, are in open disagreement" concerning this issue); *see also* Brief for the Sec. Indus. & Fin. Mkts. Ass'n et al. as Amici Curae Supporting Petitioner, Leidos, Inc. v. Indiana Pub. Ret. Sys. at 16–17, No. 16-581 (U.S. June 28, 2017), 2017 WL 2859944 (discussing approaches taken by other circuits); *Filings Database*, STAN. L. SCH. SEC. CLASS ACTION CLEARINGHOUSE, http://securities.stanford.edu/circuits.html (last visited Jan. 4, 2018) (listing securities class action filings in every circuit) (on file with the Washington and Lee Law Review).

9. 776 F.3d 94 (2d Cir. 2015).

10. 768 F.3d 1046 (9th Cir. 2014).

11. *See id.* at 103 (noting that the Ninth Circuit held that "Item 303's disclosure duty is not actionable under Section 10(b) and Rule 10b-5" (citing *NVIDIA*, 768 F.3d at 1046)).

12. *See* Lohier Op., 818 F.3d 85, 94 n.7 (2d Cir. 2016) (discussing *Stratte-McClure* and its applications to the *Leidos* case).

13. *See Leidos* Cert. Pet., *supra* note 3, at 9 ("The clashing approaches among the federal courts of appeals powerfully demonstrate the need for a uniform rule on whether plaintiffs may assert Section 10(b) claims based on omissions that are not necessary to make affirmative statements not misleading."); *Creating A Clear Circuit Split, the Second Circuit Holds That Failure to Disclose Known Trends or Uncertainties Under Item 303 of Regulation S-K Creates Liability Under Section 10(b)*, GIBSON, DUNN & CRUTCHER LLP (Jan. 22, 2015) [hereinafter GIBSON, DUNN & CRUTCHER LLP], https://www.gibsondunn.com/creating-a-clear-circuit-split-the-second-circuit-holds-that-failure-to-disclose-known-trends-or-uncertainties-under-item-303-of-regulation-s-k-creates-liability-under-section-10b/ (last visited Jan. 4, 2018) (discussing the circuit split resulting from the *Stratte-McClure* and *NVIDIA* decisions) (on file with the Washington and Lee Law Review).

authority with respect to one of the most important—and frequently invoked—provisions of the federal securities laws."[14]

Or so the conventional wisdom holds. In contrast, this Article argues that although *Leidos* did raise fundamental questions of securities law, they were not the questions that everyone supposes them to be, nor the ones that the Court likely would have addressed. The primary reason is that the circuit split that the Court is presumably seeking to resolve does not in fact exist. On the core legal question at issue in *Leidos*, the Second Circuit and Ninth Circuit are in full agreement. The relevant cases from both circuits draw on an earlier Third Circuit opinion written by then-Circuit Judge Samuel Alito, *Oran v. Stafford*[15] (*Oran*), and come to the exact same conclusion: a failure to comply with Item 303 may constitute a violation of Rule 10b-5 under some circumstances, but does not necessarily do so.[16] Only two alternatives to this outcome are logically possible: (1) noncompliance with Item 303 could always constitute a *per se* violation of Rule 10b-5, or (2) Item 303 could provide a safe harbor that can never serve as a basis for fraud claims. Neither of those positions have been adopted by any federal court to have considered the issue. As a predictive matter, then, the Court likely would have summarily affirmed the lower court decision in *Leidos*, and on the same grounds that were articulated by the Second Circuit.[17]

While this may not be the first time that the Court has stumbled into agreement with overstated rhetoric in a petition for certiorari, what is remarkable about *Leidos* is that the Cert. Petition's narrative of intractable conflict among the circuit courts has been universally embraced by surrounding commentary on the case.[18] One example is the defendants' Brief in Opposition to the

14. *Leidos* Cert. Pet., *supra* note 3, at 1.

15. 226 F.3d 275 (3d Cir. 2000).

16. *See id.* at 288 (holding that "a violation of SK-303's reporting requirements does not automatically give rise to a material omission under Rule 10b-5"); *see also Stratte-McClure*, 776 F.3d at 103 (noting that "*Oran* actually suggested, without deciding, that in certain instances a violation of Item 303 *could* give rise to a material 10b-5 omission"); *NVIDIA*, 768 F.3d at 1054–55 (agreeing with *Oran*'s reasoning regarding Item 303's disclosure requirement).

17. *See infra* Part III.B.2 (discussing the potential impacts of the *Leidos* settlement).

18. *See* Matthew Ady, *Living in a Material World: Does a Violation of Item*

Cert. Petition, which concedes that there is a circuit split on the question presented in *Leidos* but attempts to downplay its significance.[19] Other amicus briefs that were filed with the Court are even more emphatic about the presence of a split and stress the need for it to be resolved as soon as possible.[20] Law firms that specialize in securities litigation have released a number of publications aimed at updating their defense-side clients about *Leidos*, and such "client alerts" are also in accord with this consensus interpretation.[21] The same can be said for scholarly analyses: the Cert. Petition's theory of the case has been embraced by a leading securities law casebook,[22] every law journal article on

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303 of Regulation S-K Satisfy the Materiality Element in a Rule 10b-5 Cause of Action?, 17 WAKE FOREST J. BUS. & INTELL. PROP. L. 401, 439 (2017) ("Despite its 30-year pedigree, Item 303 still generates considerable confusion among courts regarding its relationship with Rule 10b-5."); Brian Currie, Note, *Much Ado About Nothing: The Limits of Liability for Item 303 Omissions and the Circuit Split That Never Was*, 8 WM. & MARY BUS. L. REV. 379, 383 (2017) ("Despite all of the commotion, the Supreme Court chose not to address the issue when given the opportunity."); Harper, *supra* note 6, at 880 (noting the pressing need for Supreme Court review on this issue in order to resolve confusion among the lower courts).

19. *See* Brief in Opposition to Petition for a Writ of Certiorari at 18, Leidos, Inc. v. Ind. Pub. Ret. Sys., No. 16-581 (U.S. Feb. 8, 2017), 2017 WL 8292356 [hereinafter Brief in Oppo to Pet. for Cert.] (admitting that there is a "nascent circuit split" while arguing that the question should be allowed to "percolate" in the lower courts because the specific procedural posture of Leidos makes it unripe for the Court to review); Reply Brief for Petitioner at 1, 7, *Leidos*, No. 16-581 (pointing out that the opposition "concedes" and "acknowledges" that there is a circuit split).

20. *See* Brief for the Sec. Indus. & Fin. Mkts. Ass'n et al. as Amici Curiae Supporting Petitioner, *supra* note 8, at 2–3, 15 ("The split that the Second Circuit has created should be resolved as speedily as possible."); Brief of Amicus Curiae Nat'l Ass'n of Mfrs. in Support of Petitioners at 2, *Leidos*, No. 16-581 ("The ruling of the Second Circuit below confirmed a conflict between the Second and the Third and Ninth Circuits on the relationship [between Item 303 and Rule 10b-5]."); Reply Brief for Petitioner, *supra* note 19, at 5–7 (discussing the split of authorities in detail).

21. *See, e.g.*, U.S. SUPREME COURT GRANTS CERTIORARI TO DECIDE ISSUE THAT MIGHT HAVE SIGNIFICANT IMPACT ON REGISTRANTS' EXPOSURE FOR NON-DISCLOSURE OF "KNOWN TRENDS OR UNCERTAINTIES" IN SEC FILINGS 3–4 (2017), https://www.sullcrom.com/siteFiles/Publications/SC_Publication _Securities_ Litigation_3_27_17.pdf (discussing the implications of the Court's upcoming decision for clients); GIBSON, DUNN & CRUTCHER LLP, *supra* note 13 (discussing the "clear circuit split" created by *Stratte-McClure* and *NVIDIA*).

22. *See* JAMES D. COX, ROBERT W. HILLMAN & DONALD C. LANGEVOORT, SECURITIES REGULATION: CASES & MATERIALS 611 (8th ed. 2017) (describing an alleged split between the Third Circuit in *Oran* and the Second Circuit in

point,[23] and several academic legal blogs that cover current developments in corporate law and securities regulation.[24]

This Article argues that the startling uniformity of (mistaken) interpretations in *Leidos* reflects more than an unhappy coincidence. Rather, it is symptomatic of fundamental misconceptions about how the securities regulation architecture works. Accordingly, the Article seeks not only to examine the legal questions directly at issue in *Leidos,* but also explore how and why it has come to be enveloped in such widespread misunderstanding. In doing so, the Article identifies two underlying sources of confusion and draws out the broader implications that those disputes carry for understanding securities regulation. One cause of the *Leidos* mix-up stems from a parallel line of case law, which addresses the intersection of MD&A disclosures with investor suits premised on Sections 11 and 12 of the 1933 Securities Act (the 33

Stratte-McClure).

23. *See, e.g.*, Harper, *supra* note 6, at 880, 900–08 (arguing that the Court must resolve the conflict among circuits relating to Item 303 and Rule 10b-5 fraud claims); Mastronardi, *supra* note 6, at 337, 350–60 ("A recent split between the Second Circuit and the Ninth Circuit provides a vivid example of the implications of a court's decision in the securities realm."); Voigt, Crawford & Galaro, *supra* note 6 ("[R]ecent disagreement between the Ninth and Second Circuits makes the discussion [of how Item 303 relates to Rule 10b-5] newly ripe.").

24. *See, e.g.*, David M. J. Rein & Hao Tschang, *Supreme Court Certiorari on Non-Disclosure of "Known Trends or Uncertainties" in SEC Filings*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Apr. 8, 2017), https://corpgov.law.harvard.edu/2017/04/08/supreme-court-certiorari-on-non-disclosure-of-known-trends-or-uncertainties-in-sec-filings/ (last visited Jan. 11, 2018) ("The U.S. Supreme Court will address a split between the Second Circuit . . . and the Third and Ninth Circuits . . . [and its decision] may have a significant impact on [public companies'] potential exposure to securities fraud claims.") (on file with the Washington and Lee Law Review); Audra Soloway et al., *Paul Weiss Discusses Securities Fraud Liability Based Solely on Omissions*, COLUM. L. SCH. BLUE SKY BLOG ON CORPS. & CAP. MKTS. (April 6, 2017), http://clsbluesky.law.columbia.edu/2017/04/06/paul-weiss-discusses-securities-fraud-liability-based-solely-on-omissions/ (last visited Jan. 11, 2018)

> On March 27, 2017, the Supreme Court granted certiorari in a potentially significant securities case . . . [and] will resolve a split between the Second and Ninth circuits caused by the Second Circuit's holding that issuers may be liable for federal securities fraud by omitting information required to be disclosed by SEC regulations.

(on file with the Washington and Lee Law Review).

Securities Act).[25] These cases have been caught in the crossfire among the Second and Ninth Circuits precedents in *Leidos*, and are at times cited as a basis of disagreement between the courts.[26]

Although the relationship between Item 303[27] and claims under the 33 Securities Act have received minimal scholarly attention, this Article takes a closer look at that question and finds that several surprising conclusions follow.[28] First, while the caselaw appears to involve a dispute over whether holdings from 33 Securities Act decisions on Item 303 may be imported into fraud actions under Rule 10b-5, none of the relevant opinions actually take such a step.[29] Instead, the consistent pattern is for courts to draw a strict divide between the 33 Securities Act provisions and Section 10(b).[30] Second, none of the rationales that the caselaw uses to distinguish the statutory authorities in this area can be justified.[31] As outlined below, the same analysis of Section 10(b) that should have driven the outcome in *Leidos* must necessarily apply with equal force to Sections 11 and 12.[32] The ironic result is

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25. *See* 15 U.S.C. § 77k(a) (2012) (codifying who may bring an action for claims of false registration statements and who is liable); *id.* § 77*l*(a)(2) (setting forth who is liable for claims related to prospectuses and communications).

26. *See* Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 104 (2d Cir. 2015) (arguing that the Ninth Circuit incorrectly interpreted the relationship between Rule 10b-5 and Section 12(a)(2) (citing Litwin v. Blackstone Grp., L.P., 634 F.3d 706 (2d Cir. 2011))); *see also* Panther Partners Inc. v. Ikanos Comm'ns, Inc., 681 F.3d 114, 120 (2d Cir. 2012) (finding that in the Item 303 context, the surrounding uncertainty concerning the flow of information is key to disclosure obligations). *See generally* Steckman v. Hart Brewing Inc., 143 F.3d 1293 (9th Cir. 1998).

27. *See* 17 C.F.R. § 229.303 (2017) ("Management's discussion and analysis of financial condition and results of operations.").

28. *Infra* Part IV.

29. *Infra* Part IV.B.

30. *Infra* Part IV.B. Roughly speaking, the 33 Securities Act decisions stand for the proposition that Item 303 violations automatically give rise to actionable claims under Section 11 or Section 12 as a matter of law in every case.

31. *See Stratte-McClure*, 776 F.3d at 104 ("But Section 12(a)(2)'s prohibition on omissions is textually identical to that of Rule 10b–5: both make unlawful omission of 'material fact[s] . . . necessary in order to make . . . statements, in light of the circumstances under which they were made, not misleading.'" (quoting 15 U.S.C. § 77*l* (2012))).

32. *Infra* Part IV.C. The reason is that the Second, Third, and Ninth Circuit decisions all turn on the materiality element in Section 10(b) claims, and the materiality standard for the 33 Securities Act and the 34 Exchange Act are identical.

that the Court had taken up the wrong case: the legal question presented by Section 10(b) in *Leidos* did not cry out for review and likely would have been affirmed as a matter of course; at the same time, however, any *Leidos* decision would have indirectly rendered a wide swath of Section 11 and Section 12 cases incorrect.[33] Third, it will be argued that this outcome, while unlikely at first glance, is representative of some wider pathologies in judicial decision-making and the legal scholarship in securities law.[34]

The other source of the *Leidos* mixup involves a controversy over a foundational doctrine in securities law known as the "duty to disclose."[35] The origins of this debate can be found in an influential scholarly critique of the way that federal courts have handled the duty to disclose in securities fraud cases relating to MD&A,[36] including then-Circuit Judge Alito's opinion for the Third Circuit in *Oran*.[37] Through an interesting twist, the theoretical

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33. *Infra* Part IV.D.

34. *Infra* Part IV.D. Namely, there is tendency to shortcut the analysis by adopting an overly narrow perspective on the relevant statutory authorities. That strategy often yields incoherent results, however, because it fails to take account of the integrated architecture of securities regulation. *See* Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83, 118 (2002) ("The key point with the shortcuts is that they serve to avoid complexity.").

35. The starting point of the confusion is dicta from an insider trading case, *Chiarella v. United States*, which has come to be cited as hornbook law for the proposition that silence, absent a duty to disclose, is not misleading under Rule 10b-5. *See* 445 U.S. 222, 230 (1980)

> [A]dministrative and judicial interpretations have established that silence in connection with the purchase or sale of securities may operate as a fraud actionable under § 10(b) despite the absence of statutory language or legislative history specifically addressing the legality of nondisclosure. But such liability is premised upon a duty to disclose arising from a relationship of trust and confidence between parties to a transaction. Application of a duty to disclose prior to trading guarantees that corporate insiders, who have an obligation to place the shareholder's welfare before their own, will not benefit personally through fraudulent use of material, nonpublic information.

36. *See* Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639, 1650–51 (2004) (citing *Oran* as a leading example of how courts' analysis of securities fraud claims go astray when they conflate the duty question with the materiality element of Rule 10b-5 actions).

37. *See generally* Oran v. Stafford, 226 F.3d 275 (3d Cir. 2000).

framework proposed in the academic literature[38] makes its way into the key precedents in *Leidos*, where it is directly referenced in Judge Livingston's *Stratte-McClure* opinion as the basis for finding the Second Circuit "at odds" with Ninth Circuit's interpretation of Item 303.[39]

As this Article will demonstrate, however, the courts' putative disagreement over the duty to disclose falls away once two pervasive misconceptions regarding the doctrine are dispelled.[40] First, contrary to the controlling view, the duty to disclose does not establish a set of conditions that may "trigger" a connection between alleged nondisclosures of MD&A information under Item 303 and fraud actions under Rule 10b-5.[41] Properly understood, the legal relationship between the two regulations is much more limited, and does not extend beyond the fact that they contain similarly worded provisions. Second, and more fundamentally, the duty issue is of limited relevance in *Leidos* because it does not play a meaningful role in the disposition of *any* securities law case (outside of the insider trading context).[42] For claims brought in connection with disclosure requirements, the duty question is entirely circular—it represents a legal conclusion rather than an intermediate step in the analysis. The takeaway for securities regulation is that theoretical debates over the meaning of the duty doctrine function primarily to obscure rather than clarify, and are best left behind by legal scholars and federal courts when dealing with disclosure cases.

In summary, this Article makes three contributions. First, it identifies overlooked aspects of a significant securities law case pending before the Court, and provides a novel analysis of how the case should have been decided. Second, this Article extends that

38. *See* Langevoort & Gulati, *supra* note 36, at 1643–44 ("Conceptually though, in order to provide a meaningful discussion about the duty question, we have to separate it carefully from the materiality question.").

39. *Id.*; *see also* Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 102 (2d Cir. 2015) (citing Langevoort and Gulati's article). The primary argument which the Second Circuit borrows from the scholarship in this area is that courts will fail to analyze securities fraud cases correctly unless they carefully separate the question of a legal duty to disclose from other elements of the claim, such as the requirement that misstatements or omissions must be material.

40. *Infra* Part V.A.

41. *Infra* Part V.B.

42. *Infra* Part V.B.2.

analysis by showing that the same misunderstandings which have accompanied the disclosure rules and securities fraud claims in the Rule 10b-5 fraud context also carry over to other areas of the securities law framework, namely Sections 11 and 12 of the 33 Securities Act. Third, it uses *Leidos* as a case study to demonstrate that a central securities law doctrine, the duty to disclose, serves little practical purpose and should play a reduced role in securities regulation. Taken together, these points suggest that *Leidos* was a much more unusual case than has been appreciated, and stands at striking confluence of legal and scholarly confusions, many of which concern fundamental principles of securities regulation.

The discussion below proceeds as follows. Part II provides regulatory and statutory background.[43] Part III introduces the *Leidos* case history and lower court opinions, explains why the circuit split at issue is illusory, and explains how that should have driven the Court's disposition of the case if it were not precluded by settlement between the parties on the eve of oral argument.[44] Part IV identifies the implications that *Leidos* carries for claims under Sections 11 and 12 of the 33 Securities Act.[45] Part V provides a revisionist interpretation of the meaning of the duty to disclose doctrine in *Leidos*, and in the securities law more generally.[46] Part VI briefly concludes.[47]

II. The Statutory & Regulatory Framework in Securities Law

A. The 1933 Securities Act & 1934 Exchange Act

Securities law pursues the twin goals of protecting investors and facilitating capital formation.[48] The main tool used to reach

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43. *Infra* Part II.

44. *Infra* Part III.

45. *Infra* Part IV.

46. *Infra* Part V.

47. *Infra* Part VI.

48. *See, e.g.*, THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION 19–22 (6th ed. 2006); Stephen J. Choi & Andrew T. Guzman, *Portable Reciprocity: Rethinking the International Reach of Securities Regulation*, 71 S. CAL. L. REV. 903, 941–45 (1998) ("One of the most cited and intuitive goals of the securities laws is the protection of investors.").

those ends is the mandatory disclosure regime.[49] The Securities Act of 1933[50] (33 Securities Act) and Securities Exchange Act of 1934[51] (34 Exchange Act), along with the attendant rules and regulations issued by the SEC, establish an elaborate regulatory framework based on this premise.[52]

The 33 Securities Act takes a transaction-based approach that requires companies to make initial disclosures when issuing securities to the public.[53] The 33 Securities Act consists of registration provisions and liability provisions.[54] In the liability

49. *See, e.g.*, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (stating that the purpose common to the securities laws was to "substitute a philosophy of full disclosure for the philosophy of caveat emptor"); Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 477 (1977) (explaining that the fundamental purpose of securities laws is replacing caveat emptor with full disclosure); Jordan v. Duff & Phelps, Inc., 815 F.2d 429, 435 (7th Cir. 1987) ("The 'duty' in question is the fiduciary duty of corporate law. Close corporations buying their own stock, like knowledgeable insiders of closely held firms buying from outsiders, have a fiduciary duty to disclose material facts."). The standard rationale for such a framework is that disclosure rules can achieve the benefits of efficient capital markets by reducing the information asymmetry between firms and investors, while avoiding the costs associated with more heavy-handed forms of intervention. *See* Williams, *supra* note 5, at 1199–200 ("The capital markets in the United States are celebrated for their financial transparency. This financial transparency derives primarily from the specific information about operating results, presented using rigorous accounting principles, that federal securities laws require public companies to report on a quarterly and annual basis."); Robert B. Thompson & Hillary A. Sale, *Securities Fraud as Corporate Governance: Reflections Upon Federalism,* 56 VAND. L. REV. 859, 885–86 (2003) (explaining that increased federal securities regulation "increases the role of shareholders by permitting them (rather than the directors) to hold officers accountable").

50. Pub. L. No. 73-22, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77bbbb (2012)).

51. Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a–78qq (2012)).

52. Congressman Sam Rayburn, who spearheaded the drafting of the 33 Securities and 34 Exchange Acts, relied heavily on Adolf A. Berle and Gardiner C. Means' book, *The Modern Corporation and Private Property*, which argued that corporate management should be held more accountable to shareholders through additional disclosure requirements. 77 CONG. REC. 2917 (1933) (statement of Rep. Rayburn). Of course, Rayburn and his contemporaries were also influenced by the writings of Louis Brandeis, who is responsible for the oft-quoted statement justifying the disclosure regime: "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 92 (1914).

53. 15 U.S.C. § 77a (2012).

54. *Id.*

provisions, Section 11 applies to registration statements,[55] while Section 12 applies to a distinct but related offering document, known as a prospectus.[56] Section 11 of the 33 Securities Act establishes liability for an untrue statement of material fact, or omission of a material fact, made in the registration statement.[57] Likewise, Section 12(a)(2) prohibits untrue statements of material fact, or omissions thereof, in any communication made in connection with a general distribution of securities through interstate commerce.[58] Sections 11 and 12 of the 33 Securities Act are prominent examples of the securities laws' joint private-public enforcement structure; these provisions create opportunities for both private suits by investors, as well as enforcement by the SEC.[59]

The 34 Exchange Act, on the other hand, reflects a periodic approach to disclosure, and contains requirements that are in effect after the securities offering has taken place.[60] This means Forms 10-K, 10-Q, and 8-K must be filed with the SEC by all companies with publicly traded securities.[61] The key liability provision in the 34 Exchange Act is the anti-fraud prohibition found in Section 10(b), and its counterpart, Rule 10b-5.[62] Rule

55. *Id.* § 77k.

56. *Id.* § 77*l*(a)(2).

57. *Id.* § 77k(a).

58. *Id.* § 77*l*(a)(2).

59. *See In re* WorldCom, Inc. Sec. Litig., 294 F. Supp. 2d 392, 407 (S.D.N.Y. 2003) (explaining that a cause of action for private suits exists under Section 11); *see also* Pinter v. Dahl, 486 U.S. 622, 642 (1988) (determining that a cause of action for private suits exists under Section 12).

60. *See generally* 15 U.S.C. §§ 78a–78nn (2012).

61. The 34 Exchange Act also created the SEC and empowered it with broad regulatory authority over the securities industry. In addition to periodic disclosures such at 10-Ks and 10-Qs, the 34 Exchange Act also requires disclosure of board elections at annual shareholder meetings, as well as information related to any major corporate event such as a merger or sale. *See generally* 15 U.S.C. §§ 78a–78nn.

62. *See id.* § 78j(b) ("It shall be unlawful for any person, . . . [t]o use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device . . . ."); *see also* 17 C.F.R. § 240.10b-5 (2017) ("It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange, to employ any device, scheme, or artifice to defraud."). The SEC finalized Rule 10b-5 in 1942.

10b-5, in pertinent part, states that it shall be 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 are made, not misleading."[63]

Liability under Section 10(b) differs from that under the 33 Securities Act's Sections 11 and 12 in a number of ways. The most important distinction is that, to bring a successful 10b-5 claim, a plaintiff must establish that he relied upon the misleading or omitted material information, and that the defendant acted with scienter.[64] In contrast, for both Section 11 and Section 12(a)(2) claims, the plaintiff is not required to plead scienter.[65] Further, unlike Sections 11 and 12, the language of Section 10(b) does not authorize lawsuits by investors, yet an implied private right of action has uniformly been read into the statute by courts.[66] In fact, Rule 10b-5 has been called the "biggest stick" in the securities laws—in part because it can be enforced not only by the SEC and private litigants, but also by the Department of Justice, which can

63. 17 C.F.R. § 240.10b-5. Courts have distilled this rule into six elements: (1) material misrepresentation or omission; (2) scienter; (3) connection between the misrepresentation or omission and the purchase or sale of a security; (4) reliance upon the misstatement or omission; (5) economic loss; and (6) loss causation. *See* Stoneridge Inv. Partners v. Scientific-Atlanta, Inc., 552 U.S. 148, 157 (2008).

64. *See generally* Tellabs, Inc. v. Makor Issues & Rights, 551 U.S. 308 (2007) (holding that the inference of scienter must be as cogent as any opposing inference of non-fraudulent intent, regardless of whether the claim is brought by a private plaintiff or the government). The scienter requirement is also accompanied by a higher pleading standard, provided by Rule 9(b) of Federal Rules of Civil Procedure (FRCP) and the 1995 Private Securities Litigation Reform Act (PSLRA). *See* FED. R. CIV. P. 9(b) ("In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally."); 15 U.S.C. § 78u-4(b)(1)–(2) ("[T]he complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.").

65. *See* PAUL VIZCARRONDO, JR., LIABILITIES UNDER THE FEDERAL SECURITIES LAWS 28 (2014), www.wlrk.com/docs/OutlineofSecuritiesLawLiabilities2014.pdf (outlining the elements for liability under the relevant sections of the 33 Securities Act and the 34 Exchange Act).

66. *See generally* Blue Chip Stamps v. Manor Drugs Stores, 421 U.S. 723 (1975).

impose criminal penalties for violations of the statute.[67] The similarities and distinctions between the 33 Securities Act Sections 11 and 12 claims and that of the 34 Exchange Act Section 10(b) prove critical in the analysis of *Leidos* and other cases, as discussed below.

B. Reg. S-K: Item 303 MD&A Rules

For decades, critics pointed out that the disclosure requirements under the 33 Securities Act and the 34 Exchange Act produced "pointless duplication."[68] As a result, the SEC eventually adopted integrated disclosure regulations in 1980, set forth in Regulation S-K (Reg. S-K).[69] Critical to the analysis provided herein are the disclosure requirements relating to MD&A found in Reg. S-K.

The historical roots of the MD&A reach back to SEC guidelines issued in 1968, which dictated that companies must include in their registration statements a discussion of "unusual conditions that affected the appropriateness of the earnings

67. *See* 17 C.F.R. § 240.10b-5 (including deceit through means of interstate commerce); *see also Blue Chip Stamps*, 421 U.S. at 737 (stating that Rule 10b-5 is "a judicial oak which has grown from little more than a legislative acorn").

68. *See* John C. Coffee, Jr., *Re-Engineering Corporate Disclosure: The Coming Debate over Company Registration*, 52 WASH. & LEE L. REV. 1143, 1145 (1995) ("Logically, a corporate issuer seeking to sell securities under a continuous disclosure system [of the 34 Exchange Act] would only be required to disclose any additional material information that it had not previously disclosed pursuant to the continuous disclosure system."). *See generally* Milton H. Cohen, "*Truth in Securities" Revisited*, 79 HARV. L. REV. 1340 (1966) (arguing that the 33 Securities Act and the 34 Exchange Act disclosure requirements should have been integrated into a single statute); STAFF OF THE U.S. SEC. & EXCH. COMM'N, REPORT ON REVIEW OF DISCLOSURE REQUIREMENTS IN REGULATION S-K 8 (2013) (summarizing the background of disclosure rules and the purpose of Regulation S-K as streamlining disclosures).

69. Reg. S-K demands a formidable amount of disclosure regarding corporate operations, governance structures, financial information, pending legal proceedings, corporate officers and board members, among numerous other topics. 17 C.F.R. §§ 229.10–1208 (2017); Amendments to Annual Report Form, Related Forms, Rules, Regulations, and Guides, SEC Release No. 33-6231, 45 Fed. Reg. 63630 (Sept. 25, 1980); Adoption of Integrated Disclosure System, Securities Act Release No. 33-6383, 47 Fed. Reg. 11380 (Mar. 3, 1982). Also adopted pursuant to the Integrated Disclosure System was Regulation S-X, which sets forth requirements for accounting statements. 17 C.F.R. §§ 210.1-01–210-12.29.

presentation and footnotes indicating adverse changes in operating results subsequent to the latest period in the earnings summary."[70] Since that time, the SEC has continued to amend the disclosure requirements pertaining to the MD&A, with an eye toward providing investors with "a narrative explanation for the financial statements, because a numerical presentation . . . may be insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance."[71] The MD&A section, by definition, includes "soft information," which relates to qualitative assessments of operating performance, in addition to "hard information" contained in quantitative overviews of companies' financial conditions.[72]

In its current form, Reg. S-K rules for MD&A require discussion of liquidity, capital resources, and results of operations.[73] Item 303 requires the identification and description of any "known trends or uncertainties" that will affect any one of the three areas (liquidity, capital resources, or operations).[74] As part of Reg. S-K, the MD&A requirements set out in Item 303 apply to both offering documents subject to the 33 Securities Act rules, and periodic post-offering disclosures that are covered by the 34 Exchange Act.[75] Unlike the liability structure for Sections 11 and 12, however, there is no statutory provision that explicitly provides a private right of action for non-compliance with the MD&A disclosure rules set out in Item 303.[76] Further, unlike causes of action stemming from Section 10(b), courts have refrained from reading an implicit private right of action into Reg.

70. Guides for Preparation and Filing of Statements, Securities Act Release No. 33-4936, 33 Fed. Reg. 18617-02 (Dec. 9, 1968).

71. Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, Securities Act Release No. 33-6711, 52 Fed. Reg. 13715-02 (Apr. 17, 1987).

72. 17 C.F.R. § 229.

73. Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Release No. 33-6835, 54 Fed. Reg. 22427-01 (May 18, 1989) [hereinafter 1989 SEC Release].

74. 17 C.F.R. § 229.303.

75. *Id.*

76. *Id.*

S-K violations.[77] The SEC retains enforcement authority, however, over violations of the disclosure requirements found in Reg. S-K.[78]

C. The Materiality Requirement

An important commonality across all four statutory authorities—Section 10(b), Section 11, Section 12, and Item 303—is the materiality requirement.[79] The disclosure requirements mandated by these provisions apply to information that is *material*. Materiality was first defined in 1976, when the Court held in *TSC Industries v. Northway, Inc.*[80] that a material fact, and therefore one that must be disclosed, is a statement that "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[81] As the Court has explained in *TSC Industries* and

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77. *See* Oran v. Stafford, 226 F.3d 275, 287 (3d Cir. 2000) (drawing this distinction and citing a string of cases that hold the same).

78. *See* Harper, *supra* note 6, at 894–900 (discussing the history of the SEC's enforcement authority over Reg. S-K disclosure requirements). For offering documents subject to Sections 11 and 12, the SEC reviews disclosures before they become effective. Likewise, for periodic disclosures subject to 10(b), such as 10-K's, the SEC also can take administrative actions by issuing cease-and-desist orders that seek injunctive relief. *See generally* C. A. Cassell, L. M. Dreher & L. A. Myers, *Reviewing the SEC's Review Process: 10-K Comment Letters and the Cost of Remediation*, 88 ACCT. REV. 1875 (2013) (assessing the effectiveness of the SEC's feedback on disclosures prior to an SEC administrative action).

79. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (articulating the materiality standard). The SEC codified this standard in its Rule 405. "The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered." 17 C.F.R. § 230.405 (2017). Rules 408 and 12b-20 also require any "such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances in which they are made, not misleading." 17 C.F.R. § 230.408 (covering 33 Securities Act disclosures); 17 C.F.R. § 240.12b-20 (applying to 34 Exchange Act disclosures).

80. 426 U.S. 438 (1976).

81. *See id.* at 448–49

> Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good. The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for

elsewhere, the purpose of materiality is to introduce a counterweight against the otherwise daunting disclosure requirements contained in both Acts.[82]

The *TSC Industries* standard provides relatively clear guidance when considering the materiality of hard facts, such as past financial information, but the parameters for materiality become less precise when considering speculative, forward-looking or "soft" information.[83] In 1988, the Court attempted to clarify that the test for estimating when speculative or forward-looking information rose to the level of "material" is the "probability versus magnitude test."[84] In *Basic Inc. v. Levinson*,[85] the Court rejected a bright-line test for materiality and held that, in the context of merger negotiations, materiality will depend on the likelihood of the future transaction taking place, and the significance of the transaction to the issuer.[86] In doing so, the Court explained it was

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> insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information[,] a result that is hardly conducive to informed decision-making.

Cf. Dale A. Oesterle, *The Overused and Under-Defined Notion of "Material" in Securities Law*, 14 U. PA. J. BUS. L. 167 (2011) (suggesting that the formulation for materiality is inherently abstract and often overbroad).

82. *See TSC Industries*, 426 U.S. at 448 ("That purpose is not merely to ensure by judicial means that the transaction, when judged by its real terms, is fair and otherwise adequate, but to ensure disclosures by corporate management in order to enable the shareholders to make an informed choice.").

83. "Forward-looking information" is defined as a statement related to or describing events or activities that will occur, if at all, at some future date. JAMES D. COX ET AL., SECURITIES REGULATION: CASES AND MATERIALS 602–05 (5th ed. 2006); 15 U.S.C § 78u-5 (2012).

84. *See* Basic Inc. v. Levinson, 485 U.S. 224, 238 (1988) ("[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.'" (quoting SEC v. Tex. Gulf Sulphur Co., 401 F.2d. 833, 849 (2d Cir. 1968))); *see also* Donald C. Langevoort, Basic *at Twenty*: *Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 152 ("*Basic* stands for the proposition that materiality is about what is important to investors, nothing more and nothing less, and offers a way (the so-called probability-magnitude test) for estimating when speculative information is sufficiently important or not.").

85. 485 U.S. 224 (1988).

86. *See id.* at 250 ("Materiality in the merger context depends on the probability that the transaction will be consummated, and its significance to the issuer of the securities. Materiality depends on the facts and thus is to be determined on a case-by-case basis.").

creating a substantively distinct test that applied to forward-looking statements and estimates.[87]

The materiality standard for claims brought under either the 33 Securities Act's Sections 11 and 12(a)(2) or the 34 Exchange Act's Section 10b are the same.[88] Materiality, for purposes of claims under either Act, is tied to the definitions set forth in *TSC Industries* and *Basic*.[89] Importantly, the SEC's regulations adopt, without alteration, the baseline *TSC Industries* standard for materiality for "hard" information.[90] However, the SEC muddied the waters in 1989 by creating a *different* standard for materiality that applies to the forward-looking information required by Item 303.[91] The SEC's test for Item 303 disclosure is as follows:

> (1) Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required; (2) If management cannot make that determination, it 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

87. *See id.* at 239 ("Generally, in order to assess the probability that the event will occur, a factfinder will need to look to indicia of interest in the transaction at the highest corporate levels.").

88. *See* Aaron J. Benjamin, *Stuck with Steckman: Why Item 303 Cannot Be a Surrogate for Section 11*, 7 HARV. BUS. L. REV. ONLINE 49, 61 n.97 (2017) (citing *In re* Worlds of Wonder, 35 F.3d 1407 (9th Cir. 1994)); Sherman v. Network Commerce, Inc., 346 F. Appx. 211, 213 (9th Cir. 2009) ("To establish materiality, plaintiffs must demonstrate a 'substantial likelihood that a reasonable investor would have acted differently if the misrepresentation had not been made or the truth had been disclosed.'" (citing Livid Holdings Ltd. v. Salomon Smith Barney, Inc., 416 F.3d 940, 946 (9th Cir. 2005))); *In re* Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347, 360 (2d Cir. 2010) ("The definition of materiality is the same for these provisions as it is under section 10(b) of the Exchange Act.").

89. *See* TSC Industries v. Northway, Inc. 426 U.S. 438, 449 (1976) (defining materiality as information that "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available"); *Basic*, 485 U.S. at 250 ("Materiality in the merger context depends on the probability that the transaction will be consummated, and its significance to the issuer of the securities. Materiality depends on the facts and thus is to be determined on a case-by-case basis.").

90. *See generally* 1989 SEC Release, *supra* note 73.

91. *Id.*

> effect on the registrant's financial condition or results of operations is not reasonably likely to occur.[92]

Thus, the plain language of the Item 303 test departs noticeably from the standard articulated in *Basic,* particularly in the second step of the test, which calls for the disclosure of known trends even where the probability that they will be important in the future cannot be estimated.[93] Most commentators who have compared the standards conclude that the procedure required under Item 303 is substantially different from the standard governing Section 10(b).[94] Moreover, the SEC explicitly makes this point in its 1989 Release, which declares the *Basic* standard "inapposite" to Item 303.[95] As explained below, the subtle but widely acknowledged differences in the materiality standards prove consequential for the legal analysis in *Leidos* and related cases that examine the relationship between Reg. S-K's MD&A rules and Section 10(b).[96]

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92. *Id.*

93. *Id.*

94. *See, e.g.*, Neach, *supra* note 6 ("Item 303 materiality standards can be both broader and narrower than the Basic test, depending on the circumstances."); John C. Coffee, Jr., *The Future of the Private Securities Litigation Reform Act*, 51 BUS. LAW. 975, 993–94 (1996) [hereinafter Coffee, Jr., *Private Securities Litigation Reform Act*] ("The MD&A's standard of materiality is different from the probability/magnitude tradeoff that the Supreme Court endorsed in Basic Inc. v. Levinson."); Donald C. Langevoort, *Toward More Effective Risk Disclosure for Technology-Enhanced Investing*, 75 WASH. U. L.Q. 753, 764 (1997) (calling the Item 303 materiality standard "murky at best"); *id.* at 775 ("the Commission's MD&A requirement expressly rejects materiality as the threshold for disclosure of 'known trends or uncertainties.' What comes in its place is a higher standard, though not much more determinate: disclosure is required only of trends and uncertainties that are 'reasonably likely to occur."). *But see* Mitu Gulati, *When Corporate Managers Fear A Good Thing Is Coming to An End: The Case of Interim Nondisclosure*, 46 UCLA L. REV. 675, 726 (1999) (arguing that the two standards are only superficially different, and that Item 303 may in some cases provide a *stricter* criterion than the standard articulated in *Basic*).

95. 1989 SEC Release, *supra* note 73, at n.27.

96. *Infra* Part IV–V.

III. Leidos*: The Illusory Circuit Split*

This Part first lays out the factual background and procedural history of the case as it developed in the Southern District of New York (SDNY) and the Second Circuit.[97] Next, it argues that, contrary to the existing commentary on the case, *Leidos* does not present an actual circuit split; instead, it reflects a consistent approach among the circuits regarding Item 303 and Section 10(b) actions.[98] The discussion then closes with some tentative predictions about how the case will be decided by the Court.[99] The subsequent Part IV and V will draw on the analysis of *Leidos* presented directly below, and show how it casts light on broader doctrinal and theoretical questions in securities regulation.[100]

A. Leidos *in the Lower Courts*

1. Factual Background & Proceedings in SDNY

Leidos began as a federal securities class action filed in the SDNY on February 22, 2012, against a technology firm doing business at the time as SAIC, Inc., and now known as Leidos, Inc.[101] The class action was initiated by the Indiana Public Retirement System as lead plaintiff, on behalf of itself and other similarly situated investors in Leidos, Inc.[102]

The class plaintiff's allegations in *Leidos* arose from a contract entered into by Leidos, Inc. and the City of New York (NYC) in 2001.[103] Pursuant to that contract, Leidos, Inc. committed to develop and implement an automated workplace management system, called CityTime, which was to be used by NYC's

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97. *Infra* Part III.A.1.
98. *Infra* Part III.A.2.
99. *Infra* Part III.A.3.
100. *Infra* Part IV & V.
101. *See generally In re* SAIC, Inc. Sec. Litig., No. 12-CV-1353, 2013 WL 5462289 (S.D.N.Y. Sept. 30, 2013) [hereinafter *In re* SAIC, Inc. Mem. & Order]. For purposes of this Article, we refer to the company simply as Leidos, Inc. throughout.
102. *Id.* at *1.
103. *Id.*

administrative agencies.[104] The initial budget for CityTime was $63 million, but its significance to Leidos, Inc. exceeded that headline dollar figure—the rollout of CityTime in New York was considered to be a proving ground that would demonstrate the program's success, and thereby lead to similar deals with municipalities across the country.[105] The project, however, did not go as planned. By late 2010, Leidos, Inc. had billed NYC $628 million for its work on CityTime, rather than the quoted $63 million.[106] Moreover, the Bloomberg administration was actively exploring ways to sever the business relationship.[107]

Spiraling costs associated with CityTime turned out to reflect more than mere logistical problems, and were in large part the byproduct of an elaborate kickback scheme orchestrated by certain Leidos, Inc. employees, including senior managers Gerard Denault and Carl Bell.[108] The details of that scheme were gradually exposed over the course of late 2010 and early 2011, as a result of (parallel but uncoordinated) investigatory efforts on the part of federal prosecutors, the NYC administration run out of Mayor Bloomberg's office, and a private law firm investigation conducted internally by Leidos, Inc. itself.[109] The details of the CityTime

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104. *Leidos* Cert. Pet., *supra* note 3, at 4.

105. Lohier Op., 818 F.3d 85, 89 (2d Cir. 2016).

106. *Id.*

107. *See Leidos* Cert. Pet., *supra* note 3, at 4 ("As of October 2011, CityTime supported more than 163,000 City employees and nearly 70 City departments. It has been hailed by City officials, including former Mayor Bloomberg, as 'a great success.'"); *see also* Amended Class Action Complaint for Violations of the Federal Securities Laws ¶ 115, *In re* SAIC, Inc. Sec. Litig., No. 1:12-cv-01353-DAB (S.D.N.Y. Sept. 30, 2013), 2013 WL 5462289 [hereinafter Am. Compl.].

108. Lohier Op., 818 F.3d at 89. Denault and Bell were paid for each hour a subcontractor or consultant worked on CityTime, and decided to hire more workers than CityTime needed in order to inflate Leidos, Inc.'s billable hours and hourly rates.

109. *Id.* at 90. The key dates are as follows. NYC and federal officials became aware of the overpayments and, in December 2010, the U.S. Attorney's Office for the Southern District of New York filed a criminal complaint regarding the fraudulent overbilling on the CityTime project. *Id.* at 91. In February 2011, the U.S. Attorney's office issued a press release announcing the indictment of CityTime consultants, one of whom had already plead guilty to fraud allegations. *Id.* at 89. On June 20, 2011, the U.S. Attorney's office issued a subsequent press release adding Denault as a defendant and announcing that Bell had pleaded guilty to charges related to the overbilling scheme. *Id.* Denault was subsequently tried and convicted of his charges in November 2013. *Id.* at 89 n.3.

fraud were confirmed to Leidos, Inc. management in an internal audit report of March 9, 2011.[110] Shortly thereafter, it became clear that the project would be a total loss.[111] On June 29, 2011, Mayor Bloomberg wrote a letter to Leidos, Inc. demanding that the company reimburse NYC the estimated $600 million in overpayments.[112] The CityTime debacle ultimately came to a close in March 2012, when Leidos, Inc. entered into a deferred prosecution agreement with the U.S. Attorney's office, in which it admitted its responsibility for the kickback fraud scheme, and agreed to pay more than $500 million in penalties.[113]

During the 2011–2012 period, Leidos, Inc. issued a number of public statements to investors, the most important of which proved to be the company's annual disclosure document, known as Form 10-K, filed with the SEC on March 25, 2011 (March 10-K).[114] The March 10-K did not include any discussion of the difficulties facing the CityTime contract with NYC, nor the ongoing civil and criminal investigations of its employees that were involved in the project, despite the fact that Leidos, Inc. management had knowledge of those developments.[115] Instead, those issues were not disclosed to investors until a series of releases that Leidos, Inc. issued during June and July of 2011, which, even then, arguably tended to downplay their significance.[116]

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110. *Id.* at 89.

111. *Id.*

112. *In re* SAIC, Inc. Mem. & Order, No. 12-CV-1353, 2013 WL 5462289, at *2 (S.D.N.Y. Sept. 30, 2013). The Bloomberg letter also called for Leidos, Inc. to pay for the costs of the forensic investigation into the project, which, when combined with the reimbursement of overpayments, likely reduced any revenue earned by Leidos, Inc. on CityTime to nearly zero.

113. Lohier Op., 818 F.3d 85, 90 (2d Cir. 2016). Leidos, Inc. also issued a "Statement of Responsibility" acknowledging the illegal conduct of Denault and Bell, taking responsibility for defrauding NYC. *Id.* Leidos, Inc. also admitted that it failed to take actions that would have detected the illegal conduct such as properly supervising Denault, controlling the costs of CityTime, or investigating anonymous ethics complaints alleging a kickback scheme. *Id.* In addition to $500 million in fines, Leidos, Inc. agreed to forfeit over $40 million in unpaid receivables. *Id.*

114. Am. Compl., *supra* note 107, ¶ 109; Lohier Op., 818 F.3d at 89.

115. Cert. Reply Brief at 7, *In re* SAIC, Inc. Sec. Litig., 12-CV-1395 (S.D.N.Y. Sept. 30, 2013), 2013 WL 5462289; Lohier Op., 818 F.3d at 95–96. Leidos, Inc. also issued an Annual Report to shareholders in March 2011 that did not mention the potential liability of the CityTime project.

116. Lohier Op., 818 F.3d at 90. On June 2, 2011, Leidos, Inc. finally issued a

The class plaintiff alleged that Leidos, Inc.'s March 2011 Form 10-K, and related disclosures, omitted information required under Item 303's MD&A rules, and therefore constituted securities fraud under Section 10(b) and Section 20(a) of the 34 Exchange Act.[117] Specifically, the plaintiff alleged that Leidos, Inc.'s knowledge of the CityTime fraud and the resulting material impact on the company was a "known[] trend or uncertainty" that should have been disclosed pursuant to Item 303.[118] In the district court, those claims were eventually dismissed with prejudice over the course of three separate decisions issued by Judge Batts.[119] Judge Batts' substantive rationale for dismissing the case was laid out in an order of January 30, 2014, which concluded that the plaintiffs had failed to adequately plead the materiality and scienter elements, both of which are required under Section 10(b).[120] The SDNY's

press release acknowledging the investigations into the CityTime contract. *Id.* The 8-K disclosed an ongoing joint criminal investigation by the U.S. Attorney and the New York City Department of Investigation (DOI). *Id.* The 8-K also stated that Leidos, Inc. had billed $635 million for the project, that it had $40 million in outstanding receivables, that Denault had been arrested for fraud, and that Leidos, Inc. had offered to refund NYC $2.5 million that Denault had billed as part of the kickback scheme. *Id.* The 8-K included language regarding the potential for adverse material effect that a possible fine or penalty could have on Leidos, Inc.'s consolidated financial position, results of operations and cash flows. *Id.* Leidos, Inc. filed its 10-Q the following day, June 3, 2011, with the same representations. *Id.* The June 2, 2011 Form 8-K also stated that Mayor Bloomberg had indicated that he would be seeking recovery of costs associated with CityTime, but that NYC had not yet filed a claim and therefore Leidos, Inc. had not recorded any liabilities other than the approximate $2.5 million it offered to refund after discovering Denault's scheme. *Id.*

117. Class Action Complaint for Violations of the Federal Securities Laws ¶¶ 77–78, 81, City of Westland Police & Fire Ret. Sys. v. SAIC, Inc., No. 12 CV 1353 (S.D.N.Y. Sept. 30, 2013), 2012 WL 590915 [hereinafter Compl.]; Am. Compl., *supra* note 107, ¶¶ 109–112. Plaintiff's cause of action under Section 20(a) is not of independent importance for purposes of this article. Section 20(a) claims are directed at individual officers and directors for "control person liability," and are derived in part from a finding of liability under Section 10(b).

118. Am. Compl., *supra* note 107, ¶ 53.

119. *See In re* SAIC, Inc. Mem. & Order, 12-CV-1353(DAB), 2013 WL 5462289, at *17 (S.D.N.Y. Sept. 30, 2013) (dismissing with leave to amend); *In re* SAIC, Inc. Sec. Litig., 12-CV-1353(DAB), 2013 WL 407050, at *6 (S.D.N.Y. Jan. 30, 2014) (dismissing with prejudice, by granting defendant's motion for reconsideration which argued that repleading the amended complaint would be futile); *id.* (dismissing plaintiff's motion for reconsideration on the prejudice issue).

120. *In re* SAIC, Inc. Mem. & Order., 2013 WL 5462289 at *4, *6. Specifically, the Order states that the "events alleged to have occurred between December

third and final order—which rejected plaintiffs' motion to reconsider the dismissal of its claims with prejudice—was entered on September 30, 2014, and served as the basis for plaintiffs' appeal to the Second Circuit.[121]

2. The Second Circuit Opinion of Judge Lohier

On March 29, 2016, a Second Circuit panel consisting of Judges Raymond Lohier, Gerard Lynch, and Susan Carney issued its decision in *Leidos*, with the opinion written by Judge Lohier.[122] The Second Circuit opinion reversed the SDNY decision, in part, by finding that plaintiffs had adequately pled materiality and scienter required for Section 10(b) with respect to the March 2011 Form 10-K.[123] The Second Circuit therefore held that the class

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2010 and March 2011 . . . are not enough to establish that the management (1) had knowledge that the company could be implicated in the CityTime project fraud or (2) could have predicted a material impact on the company . . . [and that the] alleged omissions were, at best a result of differences in professional judgment." *Id.* Notably, Judge Batts' decision is somewhat equivocal on the source of the claim at issue. It first frames Plaintiff's averments concerning Item 303 as an "allegation" made in support of a Section 10(b) claim under the pleading requirements of the PSLRA, but paragraphs later preface the discussions of materiality and scienter with a reference to "Plaintiff's Item 303 claim." *Compare id.* at *3 ("A complaint alleging securities fraud 'must [also] satisfy the heightened pleading requirements of the PSLRA and Federal Rule of Civil Procedure 9(b) by stating with particularity the circumstances constituting the fraud.'" (quoting Slayton v. Am. Express, Co., 604 F.3d 758, 766 (2d Cir.2010))), *with id.* at *11 ("Therefore, Plaintiffs' Item 303 fraud claims, with the exception of those related to the March 2011 Form 10–K, are DISMISSED with prejudice.").

121. *In* re SAIC, Inc. Sec. Litig., No. 12 Civ. 1353(DAB), 2014 WL 4953614, at *5 (S.D.N.Y. Sept. 30, 2014).

122. *See generally* Lohier Op., 818 F.3d 85 (2d Cir. 2016).

123. *Id.* at 98. The Second Circuit addressed four allegations made in the plaintiff's second amended complaint as applied to the March 2011 Form 10-K, the June 2011 Form 8-K, and the March 2011 Annual Report: (1) Leidos, Inc. failed to comply with GAAP when it omitted appropriate loss contingencies associated with CityTime, in violation of the Financial Accounting Standard No. 5 (FAS 5); (2) Leidos, Inc. failed to disclose a known trend or uncertainty reasonably expected to have a material impact on its financial condition, as required by Item 303 of Reg. S-K; (3) Leidos, Inc. acted with scienter; and (4) Leidos, Inc. issued misleading statements regarding its "commitment to ethics" in its 2011 Annual Report to shareholders. *Id.* at 88. The Second Circuit also reversed with respect to the FAS 5 allegation, but otherwise affirmed the district court's holdings regarding the June 2011 Form 8-K and the 2011 Annual Report. *Id.* at 98.

plaintiff should have been granted leave to further amend the complaint.[124] Thus, the court vacated the SDNY's order dismissing the 10(b) claims with prejudice, and remanded the case for further proceedings in the district court.[125]

While the Second Circuit opinion is not necessarily a model of clarity with respect to the relationship between Section 10(b) and Item 303, a careful reading of the decision reveals a coherent analytical framework.[126] The opinion, in pertinent part, begins with the observation that the *Leidos* class plaintiff has sued Leidos, Inc. for securities fraud in violation of Section 10(b) and Rule 10b-5.[127] The opinion then states that the issue on appeal is the sufficiency of allegations pled in support of that claim, including an assertion that Leidos, Inc. failed to comply with the disclosure requirements set forth in Item 303.[128] Thus, although subsequent language muddies the waters slightly, the Lohier Opinion opens with the premise that Section 10(b) provides the relevant cause of action, and noncompliance with Item 303 is a factual allegation pled in support of that legal claim.[129]

The Lohier Opinion then explains when an allegation that Item 303 has been violated is sufficient to plead a claim under Section 10(b), stating: "failure to comply with Item 303 *can* give rise to liability under Rule 10b-5 so long as the omission is *material* under *Basic* . . ., and the other elements of Rule 10b-5 have been established."[130] The Lohier Opinion then references the SEC's 1989

124. *Id.* at 97.

125. Lohier Op., 818 F.3d at 88. Leidos, Inc. petitioned for a panel rehearing and a rehearing en banc, both of which were denied.

126. *Id.* at 92–96.

127. *Id.* at 91.

128. *Id.*

129. Admittedly, the Lohier Opinion then proceeds to follow the format of Judge Batts' decisions, by describing the 10(b) cause of action and supporting allegations (failure to comply with Item 303, for example) interchangeably as "claims." *See, e.g.*, Lohier Op., 818 F.3d 85, 93 (2d Cir. 2016) (referring to "Plaintiffs' FAS 5 [Financial Accounting Standard #5] Claim"); *id.* at 94 (referring to "Plaintiffs' Item 303 Claim"); *see also supra* note 120 (citing to similar usage in Judge Batt's orders).

130. Lohier Op., 818 F.3d at 94 n.7 (quoting Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 103–04 (2d Cir. 2015) (internal quotation marks omitted) (emphasis in original)).

Release, setting out Item 303's particular materiality standard and knowledge requirement.[131]

Both passages in the Lohier Opinion quote the earlier Second Circuit opinion in Stratte-McClure to reiterate the proposition that "Item 303 imposes an 'affirmative duty to disclose . . . [that] can serve as a basis for a securities fraud claim under Section 10(b).'"[132]

Having explained the legal framework at issue, the Lohier Opinion then proceeded to apply that analytical framework to the specific facts alleged by the Leidos plaintiffs in their proposed second amended complaint. Lohier found that Leidos, Inc. failed to comply with Item 303.[133] The Lohier Opinion further found that the information omitted from the March 10-K was also materially misleading under Basic for purposes of Section 10(b).[134] Lastly, the Lohier Opinion determined that the heightened pleading standard of scienter under Section 10(b) was also met.[135] In light of these

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131. *Id.* at 95 (quoting Stratte-McClure v. Morgan Stanley*,* 776 F.3d 94, 101 (2d Cir. 2015) (quoting the SEC 1989 Release)). The sentence cited from the SEC 1989 Release is followed by footnote 27, which explicitly disclaims the equivalence of the materiality standard for Item 303.

132. Lohier Op., 818 F.3d at 94 n.7 (quoting Stratte-McClure v. Morgan Stanley*,* 776 F.3d 94, 101 (2d Cir. 2015)).

133. The court applied the SEC's Item 303 disclosure standard, which requires that the trend, event, commitment or uncertainty is (a) known to management; and (b) reasonably likely to have a material effect on the company's financial condition or results of operations. Using this standard, the court assessed Leidos, Inc.'s arguments that plaintiffs failed to plead that Leidos, Inc. actually knew about the fraudulent scheme in March 2011, and that the CityTime contract was not material to Leidos, Inc.'s operations as a whole. The court disagreed with Leidos, Inc. *See* Ind. Pub. Ret. Sys. v. SAIC, Inc., 818 F.3d 85, 94–96 (2d Cir. 2016) ("We reject SAIC's materiality argument, which asks us to consider quantitative factors only in the narrowest light in determining the financial impact of losing the CityTime project due to the fraud, and to otherwise ignore qualitative factors.").

134. Lohier Op., 818 F.3d at 94–96. The court rejected Leidos, Inc.'s argument that its nondisclosures were immaterial by pointing out that Leidos, Inc. anticipated the sale of CityTime software, which was valued internally at approximately $2 billion; in addition, the liability exposure of Leidos, Inc. from criminal and civil investigations was severe, and could include potential debarment from future government contracts. Based upon these facts, the court held that it was "reluctant to conclude that the alleged misstatements were 'so obviously unimportant' [to reasonable investors] that they could not be material." *Id.* (citing ECA, Local 134 IBEW Joint Pension Tr. of Chi. v. JP Morgan Chase Co.*,* 553 F.3d 187, 197 (2d Cir. 2009)) (internal citations omitted).

135. The court held that the proposed second amended complaint allegations supported a strong inference that Leidos, Inc. knew about the CityTime fraud

findings, the Second Circuit held that the class plaintiff was entitled to re-plead its Section 10(b) claim with respect to the March 10-K.[136]

It does not take a masterclass in statutory interpretation to parse out the logical structure between non-compliance with Item 303's required MD&A disclosures and actionable Section 10(b) claims articulated in the Lohier Opinion. As is repeated twice in the opinion, the former can give rise to the latter—meaning that it does under some circumstances, but not others. Therefore, a violation of Item 303 is not an automatic per se showing of securities fraud; nor does Item 303 function as some form of safe harbor, which shields MD&A disclosures (or lack thereof) from investor class actions under Rule 10b-5.[137] Moreover, the Lohier Opinion pinpoints one of the necessary further conditions that dictates whether an instance of non-compliance with Item 303 is actionable as securities fraud: it must also be the case that the pleadings reflect facts that satisfy the Basic standard of materiality under Section 10(b), in addition to the alternative Item 303 standard for materiality.

B. Leidos *at the Supreme Court*

In response to the Second Circuit's decision to remand, Leidos, Inc. filed its Cert. Petition with the Court on October 31, 2016, the same day that the class plaintiff's submitted revised pleadings

prior to its March 2011 Form 10-K, and that Leidos, Inc. also likely knew it would have to repay a significant amount of the revenue it received from the contract. Lohier Op., 818 F.3d at 94–96. The court also held that the liability exposure in Leidos, Inc. was distinguishable from that in *In re Lion's Gate Entertainment Corp. Securities Litigation*, 165 F. Supp. 3d 1, 25 (S.D.N.Y. 2016) (holding that issuers are not required to disclose the pendency of an SEC investigation), because Leidos, Inc. was aware it faced serious ongoing criminal and civil investigations. Moreover, Leidos, Inc. already had lost out on $150 million in potential additional contracts with NYC and New York State over the CityTime fraud. *See* Lohier Op., 818 F.3d at 95 n.8 ("Rather, as alleged in the PSAC, by early March 2011 SAIC was aware that it faced serious, ongoing criminal and civil investigations that exposed it to potential criminal and civil liability and that ultimately did result in criminal charges and substantial liability.").

136. *Id.*

137. *Infra* Part III.B.1.

before the SDNY.[138] After several months of briefing on the Cert. Petition by the parties in *Leidos*, as well as third party amici, the Court granted the petition on March 27, 2017 and entered *Leidos* on the docket for its October 2017 Term.[139]

1. The Cert. Petition & Alleged Circuit Split

The premise of the *Leidos* Cert. Petition is twofold. First, the relationship between the disclosure requirements of Item 303 and the liability for nondisclosure under Section 10(b) is a core issue in securities law.[140] And second, as a result of *Leidos*, there is now a "deep split of authority" among the federal circuit courts as to how that relationship is best understood.[141] Accordingly, the Cert. Petition opens by framing the "Question Presented" to the Court by *Leidos* as follows:

> Whether the Second Circuit erred in holding—in direct conflict with the decisions of the Third and Ninth Circuits—that Item 303 of SEC Regulation S-K creates a duty to disclose that is actionable under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b–5.[142]

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138. *See generally* Second Amended Class Action Complaint for Violations of the Federal Securities Laws, *In re* SAIC, Inc. Sec. Litig., 12-CV-1353-DAB (S.D.N.Y. Oct. 31, 2016), 2016 WL 7838655 [hereinafter Second Am. Compl.]; *Leidos* Cert. Pet., *supra* note 3.

139. *See* Leidos, Inc. v. Ind. Pub. Ret. Sys., 137 S. Ct. 1395 (2017) (granting cert. from the Second Circuit). *See generally Leidos* Cert. Pet., *supra* note 3; Brief in Oppo to Pet. for Cert., *supra* note 19; Reply Brief for Petitioner, *supra* note 19; Brief of Amicus Curiae Nat'l Ass'n of Mfrs. in Support of Petitioners, *supra* note 20. Although firm dates have yet to be set for the Court's review of the case, the most likely timeline is that it will hear oral arguments in late 2017 and issue a decision sometime in early-to-mid 2018. *See* UNITED STATES SUPREME COURT, OCTOBER 2017 TERM CALENDAR 1, https://www.supremecourt.gov/oral_arguments/2017TermCourtCalendar.pdf.

140. *Leidos* Cert. Pet., *supra* note 3, at 10 (providing that Item 303 involves "issue[s] of central importance to private securities litigation"); *id.* at 32 (stating that the question presented relates to a "extensively litigated and critically important area of federal securities law").

141. *Id.* at 1–2; *see also id.* at 6 ("The Second Circuit's holding [in *Leidos* entrenched a deep and expressed circuit split"); *id.* at 10–11 ("Review by this Court is necessary to resolve a question that has deeply divided the circuit courts of appeals and to clarify the circumstances under which a duty to disclose arises for purposes of Section 10(b).").

142. *Id.* at ii.

The Cert. Petition elaborates that the Second Circuit side of the split—which consists of *Leidos*, as well as *Stratte-McClure*—takes the position that a failure to comply with the terms of Item 303 is sufficient to automatically give rise to an actionable claim under Section 10(b) as well.[143] That conclusion is in direct conflict with the Ninth Circuit, the argument proceeds, in light of its opinion in a case from 2014, *NVIDIA*, which can be read to suggest that non-compliance with Item 303 can never serve as a basis for Section 10(b) liability.[144] In addition, the Cert. Petition contends that the Third Circuit is also aligned with the Ninth Circuit against the Second Circuit, based on its analysis in *Oran*. Lastly, according to the Cert. Petition, the need for the Court to resolve this core 2–1 split is particularly urgent because the split has already led to forum shopping by securities plaintiffs, and sown confusion among other federal appellate and district courts that have grappled with the same legal question.[145]

The first point made by the Cert. Petition is well taken. The SEC's rules on MD&A, which have been promulgated through Item 303 of Reg. S-K, are indeed important to the overall disclosure regime in securities law; likewise, Rule 10b-5 is the core enforcement mechanism for fraudulent disclosures.[146] However, the second proposition—that *Leidos* has created a circuit split regarding the interaction between those regulations (or more precisely, escalated an existing split)—is demonstrably false. This can be shown by a close look at the leading cases in the Second, Third, and Ninth Circuits, which reveal that there is no real disagreement over the core legal question at issue in *Leidos*.[147]

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143. *Id.* at 1–2.

144. *See id.* ("The Second Circuit answered that question in the affirmative and, in so doing, recognized that its 'conclusion is at odds with the Ninth Circuit.'").

145. *See id.* at 17 ("The present circuit split has led and will continue to lead to vastly disparate outcomes in the lower courts. Indeed, the split has already sown deep confusion among the district courts."). The Cert. petition also points out that 6th and 11th Circuits are implicated as well. *Id.* at 2.

146. *Supra* Part II.

147. Leidos, Inc.'s petition for writ of certiorari hung entirely on one statement that, when read in its plain language, makes clear that there is, in fact, no distinguishable circuit split: "The Second Circuit holds that a company's omission of disclosures required by Item 303 can subject it to 10(b) liability." *Leidos* Cert. Pet., *supra* note 3, at 10. Leidos, Inc. cites both the Second Circuit's decision in *Leidos,* as well as *Stratte-McClure*, upon which the Second Circuit

The earliest in the line of cases is a Third Circuit opinion, *Oran*, written in 2000 by then-Circuit-Judge Samuel Alito. *Oran* was a securities class action in which investors in American Home Products Corporation (AHP) brought a Section 10(b) claim against the company based on its alleged failure to disclose information relating to its line of business in a variety of weight-loss drugs collectively known as "Fen-Phen."[148] The core of the *Oran* plaintiff's legal argument was that, because AHP's omissions relating to Fen-Phen constituted noncompliance with Item 303, the same nondisclosure also constituted a material omission for purposes of Rule 10b-5.[149] The Third Circuit panel in *Oran* unanimously rejected the class plaintiff's argument and affirmed the district court, which had dismissed the case with prejudice on the grounds that the complaint had failed as a matter of law to plead the required materiality element under Section 10(b).[150]

Then-Circuit-Judge Alito's opinion addressed the relationship between Item 303 and Rule 10b-5 in detail.[151] In doing so, it focused on the materiality test for Item 303 that the SEC set out in its 1989

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relied in *Leidos,* as the source of the statement, and the source of the circuit split. Leidos, Inc. conveniently fails to acknowledge the all-important footnote 7 from the Second Circuit's *Leidos* opinion, wherein the court emphasizes that 10b-5 liability is a possibility for omissions under Item 303, "*so long as the omission is material under* Basic, *and the other elements of Rule 10b-5 have been established*." Lohier Op., 818 F.3d 85, 94 n.7 (2d Cir. 2016) (emphasis added).

148. *See* Oran v. Stafford, 226 F.3d 275, 279 (3d Cir. 2000) (explaining the basic facts of the case). The class plaintiff alleged that AHP learned about potential associations between Fen-Phen and heart disorders as early as 1995, but did not disclose this information until September 1997. *See id.* at 280 (explaining the factual basis of plaintiff's claim).

149. *See id.* at 287 (explaining the legal basis of plaintiff's claim).

150. *See id.* at 291 (affirming the district court's judgment dismissing plaintiff's claim).

151. *See id.* at 287–89 (examining plaintiff's argument in relation to Item 303 and Rule 10b-5). Specifically, "whether the disclosure mandated under Reg. S-K 303 is governed by standards consistent with those that the Supreme Court has imposed for private fraud actions [under Section 10(b)]." *Id.* at 287. Before addressing this relationship, the Third Circuit first clarified that violations of Item 303 do not create an independent cause of action for private plaintiffs. *See id.* ("In *Burlington,* this Court noted that '[i]t is an open issue whether violations of Item 303 create an independent cause of action for private plaintiffs. . . . Today, we hold that they do not.'") (internal citation omitted). The court lists a long line of cases in agreement with this holding. *See id.* at 288 (listing cases ruling that an Item 303 disclosure violation "does not inevitably lead to the conclusion that such disclosure would be required under Rule 10b-5").

Release, determining that the test "varies considerably from the general test for securities fraud set out by the Supreme Court in *Basic*."[152] As a result, the *Oran* opinion concluded that "demonstration of a violation of the disclosure requirement of Item 303 *does not lead inevitably* to the conclusion that such disclosure would be required under Rule 10b-5."[153] In *Oran*, the Third Circuit's theory of the relationship between disclosure rules for MD&A and securities fraud claims is unambiguous, and should be familiar from the foregoing review of Judge Lohier's opinion in *Leidos*,[154] which also focused on the divergence in materiality standards that the SEC articulated in its 1989 Release.[155] Far from being in conflict with the Third Circuit, then, Judge Lohier's Opinion in *Leidos* is a near replication of Justice Alito's analysis in *Oran*.[156]

The Cert. Petition's search for a disagreement between *Leidos* and the Ninth Circuit also falls short.[157] In *NVIDIA,* the defendant disclosed to investors in early 2008 that two of its products contained defects.[158] Shareholders brought a class action suit

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152. *Id.* at 288. The court quoted the SEC's 1989 Release noting that "the probability/magnitude test for materiality approved by the Supreme Court in *Basic* . . . is inapposite to Item 303 disclosure." *Id.* According to the court, Reg. S-K's 303 obligations "extend considerably beyond" those required by Rule 10b-5. *Id.* (quoting Exchange Release No. 34–26831, 54 Fed. Reg. at 22430 n.27). Based upon this reasoning, the court held that a violation of Item 303's reporting requirements does not automatically give rise to a material omission under Rule 10b-5. *See id.* ("We find this reasoning persuasive, and thus hold that a violation of SK–303's reporting requirements does not automatically give rise to a material omission under Rule 10b–5.").

153. *Id.* at 288 (emphasis added). The *Oran* opinion then reiterated that same point in equivalent terms by repeating that "[w]e . . . thus hold that a violation for SK-303's reporting requirements *does not automatically give rise* to a material omission under Rule 10b.5." *Id.* (emphasis added).

154. *See supra* Part III.A.2 (summarizing Judge Lohier's *Leidos* opinion).

155. *See* 1989 SEC Release, *supra* note 73, at 3–6 (discussing materiality standards under Item 303).

156. The word "can" carries the same meaning as the phrases "does not inevitably" and "does not automatically." The reason is the clear distinction between materiality standards for Item 303 and for Section 10(b). *See id.* at 6 n.27 (discussing the two materiality standards); Basic Inc. v. Levinson*,* 485 U.S. 224, 238–39 (1988) (setting forth the Section 10(b) standard).

157. *See Leidos* Cert. Pet., *supra* note 3, at 6–8 (discussing the split between the Second and Ninth circuits).

158. *See In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1048 (9th Cir. 2014) (detailing the plaintiffs' allegations).

against the company, alleging that NVIDIA knew about the defective products months before the 2008 disclosure.[159] As in *Oran*, the *NVIDIA* plaintiffs once again argued that the defendant corporations had a duty to disclose under Item 303 because NVIDIA's statements prior to the 2008 disclosure but after the discovery of the defects were misleading to investors, and therefore in violation of Section 10(b) and Rule 10b-5.[160] The Ninth Circuit panel in *NVIDIA* unanimously affirmed the district court, upholding its dismissal of the case with prejudice on the grounds that plaintiffs had failed to plead the scienter element of Rule 10b-5.[161]

When the Ninth Circuit's *NVIDIA* opinion delved into the intersection of compliance with Item 303 and the availability of Rule 10b-5 claims, it explicitly adopted the Third Circuit's analysis of the same issue in whole, stating that "we are persuaded by [*Oran*'s] reasoning," and proceeding to quote from Justice Alito's Opinion for the conclusion that "because the materiality standards for Rule 10b-5 and Item 303 differ significantly, the 'demonstration of a violation of the disclosure requirements of Item 303 *does not lead inevitably* to the conclusion that such disclosure would be required under Rule 10b-5. Such a duty to disclose must be separately shown."[162] In so holding, the opinion in *NVIDIA* was unequivocal on the relationship between Item 303 and Section 10(b), repeating that "what must be disclosed under Item 303 *is not necessarily* required under the standard in *Basic*."[163] The Ninth

159. *See id.* at 1048 ("According to Plaintiffs, who had purchased NVIDIA's stock in the preceding eight months, the company knew it would be liable for the defective products long before its 2008 disclosures. They claim that NVIDIA should have informed investors about the defects as early as November 2007.").

160. *See id.* ("[Plaintiffs] further contend that, absent a disclosure about the product defects, NVIDIA's intervening statements regarding its financial condition were misleading to investors, and consequently in violation of Section 10(b) of the Securities Exchange Act of 1934 and corresponding Securities Exchange Commission (SEC) Rule 10b–5.").

161. *See id.* ("The district court below dismissed Plaintiffs' amended complaint without further leave to amend, holding that it failed to adequately allege scienter, a necessary element for a claim under either Section 10(b) or Rule 10b–5. . . . For the reasons discussed below, we affirm.").

162. *Id.* at 1054–55 (quoting Oran v. Stafford, 226 F.3d 275, 288 (3d Cir. 2000)).

163. *Id.* at 1055. Relying on *Oran,* the court reiterated that the SEC's test for disclosure under Item 303 requires corporate management to make two

Circuit also emphasized that it was not breaking any new ground on the issue—in addition to referencing *Oran*, the *NVIDIA* opinion observed that its reasoning followed a multi-decade line of Ninth Circuit cases considering the same question.[164]

In conforming to the reasoning of earlier Third and Ninth Circuit opinions, *Leidos* also does not contradict prior controlling precedents from its own court, the most important of which is the opinion written by Judge Livingston in *Stratte-McClure*.[165] In *Stratte-McClure*, the Second Circuit held that "the failure to make a required disclosure under Item 303 *is not by itself sufficient* to state a claim for securities fraud under Section 10(b)."[166] The court's reasoning turned on the differing materiality standards in the two rules, invoking both the SEC's 1989 Release as well as the interpretation of the SEC's guidance in Justice Alito's *Oran* opinion.[167] The result, once again, is that non-disclosure under

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assessments: (1) whether the known trend, demand, commitment, event or uncertainty is likely to come to fruition; and (2) if management cannot make the first determination, disclosure is required unless management can determine that a material effect on the financial condition or results of operations is not reasonably likely to occur. *See id.* at 1055 (laying out the Item 303 test for disclosure (citing Management's Discussion and Analysis of Financial Condition and Results of Operations, Exchange Act Release No. 34–26831, 54 Fed. Reg. 22427, 22430 (May 24, 1989))).

164. *See id.* at 1054 ("We have confronted a similar argument before.") (citing *In re* Verifone Sec. Litig., 11 F.3d 865, 870 (9th Cir. 1993); *In re* Lyondell Petrochemical Co. Sec. Litig., 984 F.2d 1050, 1053 (1993); *In re* Convergent Tech. Sec. Litig., 948 F.2d 507, 516 (9th Cir. 1991)); *see also In re* Pac. Gateway Exch., Inc., Sec. Litig., No. C–00–1211 PJH, 2002 WL 851066, at *13 n.10 (N.D. Cal. Apr. 30, 2002) (citing *Oran* and other cases deciding the same question); Alfus v. Pyramid Tech. Corp., 764 F. Supp. 598, 608 (N.D. Cal. 1991) ("This court continues to find that defendants did not violate Rule 10b–5 by failing to comply with Item 303.").

165. *Stratte-McClure* involved Section 10(b) claims based in part on allegations that defendant had failed to disclose trends in financial products during the financial crisis that were required to be disclosed under Item 303. *See* Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 96 (2d Cir. 2015) ("[Plaintiffs] allege that Morgan Stanley and six of its officers and former officers . . . made material misstatements and omissions . . . in an effort to conceal Morgan Stanley's exposure to and losses from the subprime mortgage market."). As with *NVIDIA*, the *Stratte-McClure* affirms dismissal based on a failure to plead scienter, but also discussed the intersection of Item 303 and Rule 10b-5 at length. *See id.* (affirming the district court's dismissal of Plaintiffs' claim).

166. *Id.* at 102.

167. *See id.* at 101–04 (comparing the *Oran* standard to the standard in the SEC's 1989 Release).

Item 303 "can" give rise to a claim under Section 10(b), but "only . . . if" it also satisfies the materiality element outlined in *Basic*.[168] In other words, the Livingston Opinion in *Stratte-McClure* is in accord with Justice Alito's opinion in *Oran*, as well as subsequent application of Justice Alito's reasoning quoted by the Ninth Circuit in *NVIDIA*.[169] The logic in all three cases is simple: while not every Item 303 violation will give rise to Section 10(b) liability, some Item 303 violations also can give rise to violations of Rule 10b-5.

Stratte-McClure, however, does present one wrinkle. The Cert. Petition seizes on a portion of the Livingston Opinion that describes its analysis as being "at odds" with the Ninth Circuit in *NVIDIA*.[170] There is less to that declaration than appears at first glance.[171] The first reason that the Livingston Opinion supplies—"the Ninth Circuit's implication that . . Item 303 violations are never actionable under 10b-5"—is simply a misreading of *NVIDIA*.[172] The second reason given by the Livingston Opinion involves a side-skirmish over a parallel line of cases, which deal with the relationship between Item 303 and private investor claims under Sections 11 and 12 of the 33 Securities Act, a question

168. *See id.* at 104 ("[W]e conclude that a violation of Item 303's disclosure requirements can only sustain a claim under Section 10(b) and Rule 10b–5 if the allegedly omitted information satisfies *Basic*'s test for materiality.").

169. *Compare Stratte-McClure*, 776 F.3d at 107 ("We conclude that . . . a failure to make a required disclosure under Item 303 of Regulation S–K . . . is an omission that can serve as the basis for a Section 10(b) securities fraud claim, if the omission satisfies the materiality requirements outlined in *Basic*."), *with In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1056 (9th Cir. 2014) ("In sum, we hold that Item 303 does not create a duty to disclose for purposes of Section 10(b) and Rule 10b–5. Such a duty to disclose must be separately shown according to the principles set forth by the Supreme Court in *Basic* and *Matrixx Initiatives*."), *and* Oran v. Stafford, 226 F.3d 275 (3d Cir. 2000) ("We find this reasoning persuasive, and thus hold that a violation of SK–303's reporting requirements does not automatically give rise to a material omission under Rule 10b–5.").

170. *See Leidos* Cert. Pet., *supra* note 3, at 11 ("In *Stratte-McClure,* the Second Circuit expressly acknowledged its split with the Ninth Circuit on the Item 303 issue, stating: [O]ur conclusion is at odds with the Ninth Circuit's recent opinion in [NVIDIA]." (internal quotations omitted)). Notably, the *Leidos* Petition for Certiorari does not attribute the "at odds" comment upon which the circuit split is ostensibly based. The statement is found in *Stratte-McClure*, not *Leidos*.

171. At least for the immediate purpose of identifying a disagreement over the question presented in Item 303 cases such as *Leidos*. Parts III & IV below draw out the bigger picture issues that this confusion inadvertently tees up.

172. *Stratte-McClure*, 776 F.3d at 103.

that the Ninth Circuit does not reach in *NVIDIA* and that is only referenced in passing by the opinion in that case.[173] Therefore, despite its directness on the point, *Stratte-McClure* never identifies a genuine source of disagreement with the Ninth Circuit over the question presented in *Leidos*. Tellingly, in the Lohier Opinion in *Leidos*, there is a conspicuous absence of any mention of the Ninth Circuit, *NVIDIA*, or an inter-circuit conflict of any kind.[174]

In summary, an inspection of the 2–1 circuit split alleged in the Cert. Petition reveals a 3–0 consensus with respect to the core legal question at issue in *Leidos*: the Second Circuit (*Leidos* and *Stratte-McClure*) agrees in full with the Third Circuit (*Oran*), which in turn is entirely consistent with the Ninth Circuit (*NVIDIA* and its many predecessors).[175] The Cert. Petition's claim that cases from the Eleventh Circuit,[176] Sixth Circuit,[177] or First

173. *Compare id.* at 103 ("[W]e conclude that a violation of Item 303's disclosure requirements can only sustain a claim under Section 10(b) and Rule 10b–5 if the allegedly omitted information satisfies *Basic*'s test for materiality."), *with NVIDIA*, 768 F.3d at 1055 ("In relevant part, Item 303 requires corporate management to '[d]escribe [in 10-K and 10-Q forms] 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 also infra* Part III.

174. *See generally* Lohier Op., 818 F.3d 85 (2d Cir. 2016) (lacking discussion of *NVIDIA* or the Ninth Circuit).

175. *See* Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 107–08 (2d Cir. 2015) (ruling that failure to disclose under Item 303 can give rise to a Section 10(b) claim); *Oran*, 226 F.3d at 288 (ruling that, while an Item 303 failure can give rise to a Section 10(b) claim, it did not in this case); *NVIDIA*, 768 F.3d at 1055–57 (citing *Oran* and ruling that an Item 303 failure does not automatically give rise to a Section 10(b) claim).

176. The Eleventh Circuit case that the Cert. Petition references, *Thompson v. RelationServe Media, Inc.*, 610 F.3d 628 (11th Cir. 2010) is even less relevant. The case deals with Rule 10b-5, but Item 303 only receives passing mention as part of a 40-page concurrence, which is primarily concerned with the argument that the plaintiff's securities fraud claims were so frivolous that its counsel should be sanctioned for misconduct. When a substantive discussion of Item 303 does arrive, it deals with Reg. S-B (not Reg. S-K), and consists of a footnote that summarily agrees with Justice Alito's analysis in *Oran*. *Id.* at 682 n.78.

177. The Sixth Circuit case at issue, *In re Sofamor Danek Group, Inc.*, involved claims under Section 10(b), and included a discussion of Item 303, but the court noted that Item 303 did not appear in the complaint at all. *See id.* at 402 ("Indeed, Item 303 is not even cited in the complaint."). It then speculated in passing that a disclosure obligation under Rule 10b-5 may "perhaps" stem from Item 303—but did not explore the notion further because it found that plaintiff's alleged omission was so tenuous that no violation of either Item 303 or Rule 10b-5 had taken place. *See id.* at 403 ("The plaintiffs suggest . . . that the absence of a

Circuit[178] are incompatible is also incorrect, as is the assertion that the scattered district court decisions on point are mired in confusion.[179] By contrast, the most salient feature of *Leidos* is that, on the core legal issue in question, there is near *unanimity* among the courts.[180] This finding raises some puzzles regarding the Court's decision to issue a writ of certiorari in the first place, which presumably reflects at least partial agreement with the analysis presented in the Cert. Petition.[181] It also indicates that the Court's resolution of *Leidos*, had it been forthcoming, may not have tracked the course that the litigating parties and most other commentators anticipated.[182]

separate cause of action does not preclude plaintiffs from arguing . . . that defendants' disclosure duty under the Rule 10b-5 claim may stem from Item 303. Perhaps so . . . [but] we do not find the argument persuasive.").

178. *See generally* Shaw v. Dig. Equip. Corp., 82 F.3d 1194 (1st Cir. 1996).

179. *See, e.g.*, Beaver Cnty. Emps.' Ret. Fund v. Tile Shop Holdings, Inc., 94 F. Supp. 3d 1035 (D. Minn. 2015) ("The Second Circuit's reasoning is persuasive and consistent with this Court's reading of *Oran*. The analytical framework outlined in *Stratte–McClure* for Item 303 allegations does not conflict with the holding of Oran and will be applied accordingly."); Ash v. Powersecure Int'l, Inc., 2015 WL 54444741, at *10–11 (E.D.N.C. Sept. 15, 2015) (expressly adopting the reasoning in *Oran*, that Item 303 violations can only give rise to 10(b) claims so long as they plead the additional elements specific to 10(b)); Simon v. Am. Power Conversion Corp., 945 F. Supp. 416, 431 (D.R.I. 1996) ("The Court concludes that [Item 303] imposed an obligation to disclose the discovery of the defect in its first quarter 10–Q report, even though the effects of the discovery would not be realized for accounting purposes until the next quarter.").

180. *See, e.g.*, *Stratte-McClure*, 776 F.3d at 107–08 (ruling that failure to disclose under Item 303 can give rise to a Section 10(b) claim); Oran v. Stafford, 226 F.3d 275, 288 (3d Cir. 2000) (ruling that while an Item 303 failure can give rise to a Section 10(b) claim, it did not in this case); *In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1055–57 (9th Cir. 2014) (citing *Oran* and ruling that an Item 303 failure does not automatically give rise to a Section 10(b) claim); *see also supra* Part III.B.1; *supra* note 175 and accompanying text (noting that circuits are in agreement that an Item 303 failure does not automatically gives rise to a Section 10(b) claim).

181. The NVIDIA Cert. Petition, which contains an identical question presented, was denied by the Court. Cohen v. NVIDIA Corp., 135 S. Ct. 2349 (2015); *see also* Petition for Writ of Certiorari at i, Cohen v. NVIDIA Corp., No. 14-975 (U.S. 2015), 2015 WL 603147

> Question Presented: Whether Item 303 of Regulation S-K forms the basis for a duty to disclose otherwise material information for purposes of an omission actionable under § 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 as the Second Circuit recently held in direct conflict with the Ninth Circuit's holding in this case?

182. *See generally* Matthew C. Turk & Karen Woody, Leidos *and The Roberts*

2. The Leidos *Settlement and Supreme Court Opinion It Foreclosed*

In an unusual twist to an already unusual case, the parties in *Leidos* announced a tentative settlement weeks before the Supreme Court was set to hear oral argument, and have successfully moved to hold the case in abeyance on the Court's docket until the proposed settlement is ultimately rejected or approved.[183] If the settlement is not approved by the Southern District of New York by spring of 2018, *Leidos* will be back on the Supreme Court's docket for the October 2018 term.[184] To date, the terms of the settlement have not been disclosed. While it is therefore quite difficult to speculate at the particular litigation strategy that drove the parties' settlement calculus, it is worth noting that *Leidos* will not be the first securities law case in recent years that was withdrawn from the Court's docket prior to oral argument. In a 2014 case, *Public Employees' Retirement System v. IndyMac MBS, Inc.*,[185] which asked whether filing a securities class action tolls the statute of limitations for all members of the class, the Court held—just one week prior to scheduled argument—that certiorari had been improvidently granted.[186] And in 2013, the parties in *UBS Financial Services, Inc. v. Union de Empleados de Muelles*[187] settled two months after Cert. was granted.[188]

Court's Improvident Securities Law Docket, 70 STAN. L. REV. ONLINE 89 (2017) (discussing implications of the *Leidos* case for the Supreme Court's broader securities law jurisprudence under Chief Justice John Roberts).

183. *See generally* Leidos, Inc. v. Ind. Pub. Ret. Sys., No. 16-581, 2017 WL 4622142 (U.S. Oct. 17, 2017) (granting stay of argument in the case).

184. *See id.* (holding *Leidos* in abeyance).

185. 135 S. Ct. 42 (2014).

186. *See id.* at 42 ("Writ of certiorari to the United States Court of Appeals for the Second Circuit dismissed as improvidently granted.").

187. 134 S. Ct. 40 (2013).

188. *See id.* at 40 (dismissing the petition for writ of certiorari on August 26, 2013); *see also* UBS Fin. Servs. Inc. v. Union de Empleados Muelles, 133 S. Ct. 2857 (2013) (granting Cert. on June 24, 2013). Another interesting precedent is *Comcast Corp. v. Behrend*, which was settled shortly before the Court's grant of certiorari, yet ultimately produced a Supreme Court opinion on the question presented despite the pending settlement. 569 U.S. 27 (2013). *See also id.* (Ginsburg, J., dissenting) (dissenting in part on the grounds that "we would dismiss the writ of certiorari as improvidently granted").

Putting the settlement aside, it is still worth addressing how the Court should (and likely would) have decided *Leidos*, had the opportunity materialized. On the one hand, the Cert. Petition paints the picture of a complex case, in which the Court must adopt one side of a contentious circuit split over crucial interpretive difficulties in securities law. On the other hand, a careful look at the underlying legal authorities suggests that *Leidos* actually presents relatively straightforward legal questions. Rather than crafting a creative solution to the supposed clash among the circuits, the Court probably will affirm *Leidos* in summary fashion, both with respect to the Second Circuit's reversal of the SDNY's dismissal of the case, as well as the underlying legal analysis that the Lohier Opinion relies upon to do so.

A reversal of the Second Circuit's determination in *Leidos* seems unlikely because the facts alleged in the class plaintiff's pleadings easily meet the required materiality and scienter standards for purposes of stating a claim under Section 10(b).[189] CityTime was one of the most important projects under contract at Leidos, Inc., and, by the time its March 2011 Form 10-K was issued, the CityTime deal had essentially collapsed due to a brazen fraud scheme that both NYC and federal authorities were actively prosecuting.[190] If that is not a material fact, nothing is.[191] The *Leidos* plaintiffs' pleadings also established that, a week before the March 10-K was released, management at Leidos, Inc. were briefed on the CityTime issues in the form of a final report from an internal investigation commissioned in light of preexisting concerns over the project.[192]

189. *See* Lohier Op., 818 F.3d 85, 96–97 (2d Cir. 2016) (discussing the materiality and scienter arguments, finding for the plaintiff).

190. *See supra* Part III.A.1 (reviewing the factual allegations in *Leidos*).

191. Leidos, Inc.'s stock price fell roughly 25% as the problems with CityTime gradually became public knowledge during this period, and did not begin to rebound until late 2011. *See Leidos Holdings, Inc. (LDOS)*, YAHOO! FIN., https://finance.yahoo.com/quote/LDOS/history?p=LDOS (last visited Apr. 26, 2017) (listing historical prices for Leidos Holdings stock) (on file with the Washington and Lee Law Review); *cf. In re* Westinghouse Sec. Litig., 90 F.3d 696, 714 (3d Cir. 1996) (using a much less significant metric—a 5%–10% drop in quarterly net income—as a benchmark rule of thumb for determining whether nondisclosed subject matter is material).

192. *See supra* Part III.A.1 (reviewing the factual allegations in *Leidos*).

Pleading scienter often presents a challenging hurdle that requires tying together chains of circumstantial evidence in order to make an inference of fraud, or even reckless behavior, plausible.[193] By contrast, the allegations in *Leidos* provide compelling evidence that Leidos, Inc. had actual knowledge of the undisclosed material facts at issue, which is the most robust showing of scienter that is practically possible.[194] These points reflect an additional oddity about *Leidos*. Namely, that the lack of any discernible justification for the SDNY's dismissal with prejudice means the case should never have reached the Second Circuit, let alone the U.S. Supreme Court.

In affirming the *Leidos* decision, the Court would also likely have followed the same underlying legal analysis that was applied in the Lohier Opinion, for a number of reasons.[195] Most importantly, as discussed above, there is no circuit split that provides a counterargument, or even introduces disagreement, on this point.[196] And, in addition to reflecting the consensus position of other federal courts, the Lohier Opinion also has the virtue of being legally sound. The SEC has explicitly opined that the definition of materiality used for MD&A disclosures differs from

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193. *See* Tellabs, Inc. v. Makor Issues & Rights, 551 U.S. 308, 319–22 (2007) (discussing various standards for pleading scienter); *see also* Coffee, Jr., *Private Securities Litigation Reform Act*, *supra* note 94, at 978–85 (discussing the pleading standard for scienter, as codified under the 1995 PSLRA); *cf.* Donald C. Langevoort, *Reflections on Scienter (and the Securities Fraud Case Against Martha Stewart that Never Happened)*, 10 LEWIS & CLARK L. REV. 1, 5–8 (2006) (comparing "purpose" and "awareness" standards for scienter).

194. Lohier Op., 818 F.3d 85, 96–97 (2d Cir. 2016)

> [T]he allegations in the PSAC strongly suggest that . . . when SAIC received the results of its internal investigation but before it filed its 10–K, SAIC knew about Denault's kickback scheme, the extent of the CityTime fraud . . . and that it risked civil and criminal fines and penalties, let alone losing a significant number of current and future government contracts. We conclude that the allegations support the inference that SAIC acted with at least a reckless disregard of a known or obvious duty to disclose . . . .

195. That is, that an allegation of noncompliance with Item 303 can in some circumstances sustain an actionable claim under Section 10(b) but does not do so automatically, because securities plaintiffs must further show that the elements unique to Rule 10(b)-5, such as the *Basic* materiality standard, have also been met. *See supra* Part III.A.2 (discussing the Second Circuit's Lohier Opinion in *Leidos*).

196. *See supra* Part III.B.1 (analyzing the *Leidos* Cert. Petition).

the standard applicable to securities fraud claims.[197] Lastly, the Lohier Opinion tracks the reasoning of at least one member of the Court, Justice Alito, whose opinion for the Third Circuit in *Oran* laid out the blueprint that subsequent Second and Ninth Circuit decisions have followed, including *Leidos*.[198]

Thus, it was never very likely that the Supreme Court would have pronounced that the Second Circuit erred in finding violations of Item 303 and claims under Rule 10b-5 to be functionally distinguishable. Such a conclusion would require ignoring the interpretative authority of the SEC, the plain language of the two materiality standards themselves, and the bulk of the scholarly research that compares them.[199] To be sure, the fact that this article's analysis of *Leidos* departs from the Cert. Petition's theory of the case is not necessarily a startling result. Petitions to the Court are exercises in legal advocacy just like any other lawyer's brief, and tend to cast the case in the most controversial and grandiose terms possible. Moreover, an order granting Cert. does not always indicate that the Court has bought into the claims presented in the Cert. petition, and cases might be taken up to clarify tangentially related issues.[200]

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197. *See* 1989 SEC Release, *supra* note 73, at 6 n.27 ("MD&A 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 probability/magnitude test for materiality . . . in *Basic* . . . is inapposite to Item 303 disclosure." (internal citation omitted)).

198. *Compare* Lohier Op., 818 F.3d at 96 (allowing qualitative factors in the materiality determination), *with* Oran v. Stafford, 226 F.3d 275, 282 (3d Cir. 2000) (explaining then-Judge Alito's materiality framework). *But cf.* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 27 (2011) (highlighting that Justice Alito joined the majority opinion, which rejected certain aspects of the materiality analysis that the Third Circuit used in *Oran*).

199. *See Oran*, 226 F.3d at 287 (noting the SEC's interpretive authority on its disclosure rules, including Item 303). One provocative alternative scenario is that the Court finds the cases in all three circuits to be wrongly decided, based on theory that the gap between the materiality standards of Item 303 and Rule 10b-5 exists but is too trivial to matter at that pleading stage, and is only relevant in securities class actions for purposes of an ultimate finding of liability.

200. *Cf.* Henry Paul Monaghan, *On Avoiding Avoidance, Agenda Control, and Related Matters*, 112 COLUM. L. REV. 665, 668–69 (2012) (contrasting the "dispute resolution" and "law declaration" models that are used to explain how the Supreme Court exercises its discretion to select cases for review).

What is remarkable about *Leidos*, however, is that the narrative urged by the Cert. Petition reappears unchanged in essentially all other commentary on the case. The universal failure to unravel the Cert. Petition's alleged circuit split, and to acknowledge that *Leidos* is in fact an easy case, call for an explanation. The most obvious source of responsibility can be attributed to the decision in *Stratte-McClure*, which declared that the Second Circuit is "at odds" with the Ninth Circuit's interpretation of Item 303 in *NVIDIA*.[201] But that is a superficial source of the problem; a quick cross-reference of the relevant passage in the Livingston Opinion reveals that it turns on stray language in *NVIDIA* that does not raise a genuine dispute over the question presented in *Leidos*.[202]

How did *Leidos* work its way to the brink of a Supreme Court decision? This is a critical question, given that the core legal question presented in *Leidos* does not reflect any genuine dispute among federal appellate courts. As will be argued, one explanation for the *Leidos* mix-up concerns the relevance of a parallel line of cases, which consider the relationship between Item 303 and actions brought pursuant to Sections 11 and 12 of the 33 Securities Act.[203] Another source of confusion relates to the interaction between the duty to disclose MD&A information, set forth Item 303 of Reg. S-K, and securities fraud claims under Section 10(b) of the 34 Exchange Act.[204] These issues are addressed in turn by the subsequent two Parts below.

201. Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 103 (2d Cir. 2015). This language is cited in the first paragraph of the Statement of the Case in the *Leidos* petition for Cert., yet does not arise from the lower court decision in *Leidos*. Judge Livingston argues in dicta that the *NVIDIA* court erroneously implies that *Oran* "*compels* a conclusion that Item 303 violation are never actionable under 10b-5." *Id.* (emphasis in original).

202. *See supra* Part III.B (analyzing the *Leidos* case).

203. This concept, and its broader application to the field of securities regulation, will be addressed in Part III. With its review of *Leidos*, the Court will be resolving a securities class action that brings fraud claims under Section 10(b) of the 34 Exchange Act, and turns on allegations relating to Item 303 periodic filings under that same statute. As part of the SEC's integrated disclosure system under Reg. S-K, however, Item 303 requires that the same MD&A information be included in a separate set of disclosures mandated under the 33 Securities Act, which are private suits under Sections 11 and 12 of that act. *See supra* Parts I–II (discussing the applicable law and *Leidos*, respectively).

204. *See supra* Parts II–III (discussing the different duties of disclosure).

IV. Nondisclosure Claims & the 33 Securities Act

This Section unravels the underlying cause of the controversy over 33 Securities Act claims that arise in *Leidos*. It shows how the supposed circuit split on the topic is much less substantial than an overlooked *intra*-court split, wherein the Second and Ninth Circuits' analysis of Item 303 and Section 10(b) implicitly contradict their own line of opinions on Item 303 and Sections 11 and 12.[205] Generally, the Second and Ninth Circuits have held that Item 303 violations can give rise, in a per se fashion, to liability under the 33 Securities Act.[206] Yet cases in the same circuits brought under Section 10(b) find that Item 303 violations merely have the possibility of creating liability, provided that materiality standards are met.[207] Thus, placing the Sections 11 and 12 cases in proper perspective alongside their Section 10(b) counterparts carries broad implications. The discussion below addresses this conundrum, and provides reflections on what the incoherence in this area of the law says about judicial interpretation of securities regulation more broadly.

A. Origins of the 33 Securities Act Muddle in Leidos

The Cert. Petition in *Leidos* twice attempts to conjure up a circuit split over 33 Securities Act cases.[208] In framing the issue,

205. *See infra* Part IV.C (explaining the split between the Second and Ninth Circuits).

206. *See, e.g.*, *Stratte-McClure*, 776 F.3d at 104 ("The Ninth Circuit's opinion in *NVIDIA* also misconstrues the relationship between Rule 10b–5 and Section 12(a)(2) of the Securities Act. In *Litwin* and *Panther Partners,* we established that Item 303 creates a duty to disclose for the purposes of liability under Section 12(a)(2)." (citing Litwin v. Blackstone Grp., L.P., 634 F.3d 706, 716 (2d Cir. 2011))); *see also* Panther Partners Inc. v. Ikanos Comm'ns, Inc., 681 F.3d 114 (2d Cir. 2012); Steckman v. Hart Brewing Inc., 143 F.3d 1293 (9th Cir. 1998).

207. *See, e.g.*, *Stratte-McClure*, 776 F.3d at 107–08 ("We conclude that, as a matter of first impression in [the Second Circuit], a failure to make a required disclosure under Item 303 . . . can serve as the basis for a Section 10(b) securities fraud claim, if the omission satisfies the materiality requirements."); *In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1054 (9th Cir. 2014) ("[The Ninth Circuit has] never directly decided whether Item 303's disclosure duty is actionable under Section 10(b) and Rule 10b–5. We now hold that it is not.").

208. *See Leidos* Cert. Pet., *supra* note 3, at 1–2, 8 ("This case presents a deep split of authority with respect to one of the most important—and frequently

the Cert. Petition claims, "unlike the Ninth Circuit, the Second Circuit thought it both relevant and persuasive that a number of prior decisions, including two of its own, held that Item 303 omissions were actionable under Sections 11 and 12."[209] The Cert. Petition later flips the point by stating that the Ninth Circuit "rejected plaintiff's reliance on Second Circuit cases" that examined when Item 303 is actionable under Sections 11 and 12 of the 33 Securities Act.[210] Because the Lohier Opinion in *Leidos* does not reference the Ninth Circuit at all, the Cert. Petition grounds both claims in the passage[211] from *Stratte-McClure* where Judge Livingston announced the Second Circuit's disapproval of the Ninth Circuit's analysis in *NVIDIA*.[212] The specific language from *Stratte-McClure* is therefore most revealing of the relevant bases for the Cert. Petition's assertions.[213]

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invoked—provisions of the federal securities laws.").

209. *Id.* at 8.

210. *Id.* at 14.

211. *See* Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 104 (2d Cir. 2015) ("The Ninth Circuit's opinion in *NVIDIA* also misconstrues the relationship between Rule 10b–5 and Section 12(a)(2) of the Securities Act.").

212. *See Leidos* Cert. Pet., *supra* note 3, at 8, 14 (citing *Stratte-McClure* for both propositions). Interestingly, the Lohier Opinion in *Leidos* references these two Second Circuit cases cited in the Cert. Petition only to establish the point that the "trend or uncertainty" required by Item 303 must be affirmatively known to the issuer. Lohier Op., 818 F.3d 85, 95–96 (2d Cir. 2016). In other words, a reckless or negligence standard of "should have known" is not applicable for Item 303. The Lohier Opinion does not discuss liability under Sections 11 and 12 at all.

213. *See Stratte-McClure*, 776 F.3d at 104

> In *Litwin* and *Panther Partners,* we established that Item 303 creates a duty to disclose for the purposes of liability under Section 12(a)(2). The Ninth Circuit had also adopted that position. In *NVIDIA,* a panel of the Ninth Circuit found these decisions irrelevant to its interpretation of Rule 10b–5. But Section 12(a)(2)'s prohibition on omissions is textually identical to that of Rule 10b–5: both make unlawful omission of material fact[s] ... necessary in order to make ... statements, in light of the circumstances under which they were made, not misleading. SEC regulations, like Item 303, dictate the contents of mandatory disclosures—be they Form 10–Qs in the case of Rule 10b–5 or prospectuses in the case of Section 12(a)(2)—and are therefore an essential part of the circumstances under which such disclosures are made. *Litwin* and *Panther Partners* recognized that issuing financial statements that omit elements required by Item 303 can mislead investors. Those decisions provide firm footing for our decision in this case.

(internal citations and quotation omitted).

The *Stratte-McClure* decision, written by Judge Livingston, accuses the *NVIDIA* court of "misconstru[ing] the relationship between Rule 10b-5 and Section 12(a) of the [33] Securities Act."[214] The Livingston Opinion proceeds by noting that *NVIDIA* found three decisions concerning Item 303 and Sections 11 and 12 irrelevant—a pair of Second Circuit cases, *Panther Partners Inc. v. Ikanos Communications, Inc.*[215] and *Litwin v. Blackstone Group, L.P.*,[216] along with a precedent from the Ninth Circuit, *Steckman v. Hart Brewing, Inc.*[217] (*Steckman*).[218] According to Judge Livingston, ignoring the holdings in those cases was a mistake, because "[Section 12 prohibitions] on omissions is textually identical to that of Rule 10b-5."[219] Because *Litwin* and *Panther Partners* established that Item 303 creates a duty to disclose for purposes of Sections 11 and 12, the Second Circuit was on "firm footing" in transporting the same conclusion to the Section 10(b) context.[220]

The logic of the Livingston Opinion's critique appears plausible at first blush, but does not fare well under further scrutiny. A premise of the argument is that, by failing to incorporate the logic of the 33 Securities Act cases that discuss Item 303, *NVIDIA* came to an incorrect conclusion in the Section 10(b) context. But the Livingston Opinion's attempt to undercut the Ninth Circuit on these grounds amounts to a non sequitur because the *Stratte-McClure* and *NVIDIA* decisions are in full agreement: each case held that Item 303 violations *can*, under

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214. *Id.* Early portions of the Livingston Opinion make clear that the Ninth Circuit's misconstrual pertains to Section 11 as well as Section 12. *See id.* at 101 ("[The Second Circuit has] already held that failing to comply with Item 303 by omitting known trends or uncertainties from a registration statement or prospectus is actionable under Sections 11 and 12(a)(2) of the Securities Act of 1933." (citing *Panther Partners*, 681 F.3d at 120; *Litwin*, 634 F.3d at 716; J&R Mktg. v. Gen. Motors Corp., 549 F.3d 384, 392 (6th Cir. 2008); Silverstrand Inv'rs v. AMAG Pharm., Inc., 707 F.3d 95, 102–03, 107 (1st Cir. 2013))).

215. 681 F.3d 114 (2d Cir. 2012).

216. 634 F.3d 706 (2d Cir. 2010).

217. 143 F.3d 1293 (9th Cir. 1998).

218. *See Stratte-McClure*, 776 F.3d at 104 (citing *Steckman* for the proposition that the Ninth Circuit adopted the position that "Item 303 creates a duty to disclose for the purposes of liability under Section 12(a)(2)").

219. *Id.*

220. *Id.*

some circumstances, also give rise to fraud claims under 10(b), but do not automatically do so in every case.[221] Even more oddly, the *Stratte-McClure* decision is itself in tension with the very same Section 12 cases that Judge Livingston argues should have served as a template for *NVIDIA*.[222] With some ambiguities aside, the thrust of the 33 Securities Act opinions is that non-compliance with Item 303 functions as a per se "surrogate" for securities law private rights of action in every case.[223] Yet if the same analysis applies across both 34 Exchange Act and 33 Securities Act cases, as Livingston contends, and if the two lines of cases also call for different outcomes, then it follows that one entire series of Item 303 cases has been wrongly decided. Thus, the stakes of the convoluted crossfire between the circuits in this area are potentially quite high, and it is worth parsing out what exactly the 33 Securities Act cases hold.

B. The Parallel Caselaw on Sections 11 & 12

A review of the three precedents concerning Sections 11 and 12 suggests that they do not apply the same analysis as the cases analyzing Section 10(b). This is undeniably the case with the Ninth Circuit precedent, *Steckman*, which cannot be reconciled with *Stratte-McClure*. It is also the most natural reading of the Second Circuit precedents, *Litwin* and *Panther Partners*, although they are far from clear, and susceptible to varying interpretations.

In *Steckman*, plaintiffs brought a class action alleging that defendants failed to disclose in the registration statement and prospectus that sales and earnings had plateaued prior to the initial public offering.[224] The defendant underwriters argued that even if the plaintiffs had stated a claim sufficient to show a violation of Item 303, their showing was not sufficient to state a

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221. *See id.* at 103–04 ("At a minimum, *Oran* is consistent with our decision that failure to comply with Item 303 in a Form 10–Q can give rise to liability under Rule 10b–5. . . ."); *In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1055 (9th Cir. 2014).

222. *See infra* Part IV.B (discussing other case law on Sections 11 and 12).

223. *See id.* (same).

224. *See Steckman*, 143 F.3d at 1295 (laying out the factual basis of the plaintiffs' claim).

cause of action under Sections 11 and 12.[225] In other words, the underwriters argued that Item 303 cannot serve as a surrogate for Sections 11 and 12 liability.[226] The Ninth Circuit disagreed, and seemingly created a bright-line rule: "[A]ny omission of facts 'required to be stated' under Item 303 will produce liability under Section 11."[227] In defense of this premise, the court cited a Third Circuit decision, *Craftmatic Securities Litigation v. Kraftsow*,[228] which included the following stark statement: "[D]isclosures mandated by law are presumably material."[229] The *Steckman* court further stated that the same standard for Section 11 claims applies for Section 12(a)(2) liability.[230] Curiously, however, the *Steckman* court declined to extend the same logic to Section 10(b) claims, distinguishing such liability on the basis that Section 10(b) "has only an implied right of action" and therefore "differs significantly from Sections 11 and 12(a)(2) of the 33 Securities Act, which have express rights of action."[231]

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225. *See id.* at 1296 ("The [defendants] also argue . . . that Steckman's pleadings, even if they did state the elements required to show a violation of Item 303 . . . would not be sufficient to state a cause of action under the Securities Act.").

226. *See id.* ("The [defendants] also argue that an alleged violation of [Item 303] does not necessarily give rise to a cause of action under sections 11 and 12(a)(2)."); *see also* Benjamin, *supra* note 88, at 9 (noting the *Steckman* defendants' argument).

227. Steckman v. Hart Brewing, Inc., 143 F.3d 1293, 1296 (9th Cir. 1998).

228. 890 F.2d 628 (3d Cir. 1990).

229. *Steckman*, 143 F.3d at 1296 (citing *Craftmatic Sec. Litig.*, 890 F.2d at 641 n.17). *Steckman* creates the presumption that any omission, material or not, required by Item 303 automatically gives rise to liability under Sections 11 and 12. Taken to its logical conclusion, *Steckman* creates a per se statutory violation giving rise to automatic Section 11 and 12 liability for any omission or misstatement of all mandated, but not necessarily material, information.

230. *See id.* ("Allegations which state a claim under Item 303(a) of Regulation S–K also sufficiently state a claim under Sections 11 and 12(a)(2).").

231. *See id.* (declining to extend the rationale of *In re VeriFone Securities Litigation,* 11 F.3d 865 (9th Cir. 1993), because it involved a claim under Section 10(b), not Sections 11 or 12). Despite equating Item 303 and Sections 11 and 12 liability standards, the court nevertheless affirmed the district court's dismissal of the complaint in *Steckman*, finding that management could not have expected a sales and earnings slowdown to have a material impact on net sales, revenues or income. *See id.* at 1297–98 ("Pyramid's management could not under any imaginable standard have reasonably expected that the slowdown was anything more than a regular fourth quarter slowdown or that it would have a material impact on net sales, revenues or income.").

In *Litwin*, defendant Blackstone Group, L.P. declined to disclose in its registration statement and prospectus that two of its portfolio companies, and its real estate fund, were experiencing problems due, in part, to the real estate crash, and that those problems substantially affected Blackstone's revenues.[232] Dismissing the complaint, the district court ruled that Sections 11 and 12 do not require disclosure of publicly available information such as macro-economic conditions.[233] Further, the district court held that plaintiffs had failed to allege any facts that would render Blackstone's affirmative statements misleading, nor had plaintiffs alleged that Blackstone knew that the market conditions would have a material effect on its investments.[234] On appeal, the Second Circuit ruled that Item 303 required Blackstone to disclose the omitted information of real estate trends, provided the information was material.[235] The Second Circuit thereby remanded to the district court, allowing plaintiffs to amend their complaint.[236] Thus, according to *Litwin*, Item 303 clearly establishes a duty to

232. *See* Litwin v. Blackstone Grp., L.P., 634 F.3d 706, 710 (2d Cir. 2011) ("[T]wo of Blackstone's portfolio companies as well as its real estate fund investments were experiencing problems. Blackstone allegedly knew [that] . . . these problems to subject it to a claw-back of performance fees . . . thereby materially affecting its future revenues.").

233. *See id.* at 714 ("The District Court further found that . . . Sections 11 and 12(a)(2) do not require disclosure of publicly available information: 'The omission of generally known macro-economic conditions is not material because such matters are already part of the 'total mix' of information available to investors.'" (citation omitted)).

234. *See id.* ("[T]he District Court noted that the complaint contained no allegations that Blackstone knew that market conditions were reasonably likely to have a material effect on *its* portfolio of real estate investments." (emphasis original) (internal quotation omitted)).

235. *See id.* at 722 ("[T]he alleged misstatements and omissions regarding real estate were qualitatively material because they masked a potential change in earnings or other trends."). The court ruled that the pleading standard for Section 11 places a minimal burden on the plaintiff, such that a material omission of information necessary to prevent existing disclosures from being misleading gives rise to liability. *See id.* at 716 ("Section 11 places a relatively minimal burden on a plaintiff." (internal quotation omitted)). The court also stated that the same standard applies to Section 12(a)(2) claims. *See id.* at 715 (stating that "Section 12(a)(2) imposes liability under similar circumstances. . . ." as Section 11). Thus, to overcome a 12(b)(6) motion to dismiss, only proof of a material omission is required.

236. *See id.* at 723 (vacating the District Court's judgment and remanding).

disclose material information, giving rise to liability under Sections 11 and 12.[237]

Likewise, in *Panther Partners*, the Second Circuit held that plaintiffs adequately alleged that defendants had not sufficiently disclosed, both in the registration statement and prospectus, the extent of the defect in their semiconductor product, in violation of Item 303.[238] Relying on its holding in *Litwin*, the court acknowledged that Item 303 provided the basis for the duty to disclose; the court then performed a fact-based analysis and held that plaintiffs should have been granted leave to amend their complaint because the defect "might reasonably be expected to have a material impact on future revenues."[239] In its conclusion, the court stated that plaintiffs adequately alleged that defendants had "failed to comply with Item 303."[240] This sentence manifests the confusion swirling among these cases, given that Item 303 is not a cause of action in itself; instead, the cause of action in *Panther Partners* was a violation of Sections 11 and 12.[241]

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237. *See id.* (holding that "plaintiffs plausibly allege that Blackstone omitted from its Registration Statement and Prospectus material information related to its investments in FGIC and Freescale that Blackstone was required to disclose under Item 303 of Regulation S–K"). The materiality requirement balances against the risk of information overload. *See id.* at 722 (explaining how the materiality requirement reduce informational burdens on financial institutions). The court also noted that the test for materiality under Sections 10(b) and Sections 11 and 12 is identical. *See id.* at 719 n.10 ("[T]he test for materiality is the same when claims are brought pursuant to Sections 11 and 12(a)(2) of the Securities Act."). *But cf.* J&R Mktg., SEP v. Gen. Motors Corp., 549 F.3d 384, 397 (6th Cir. 2008) (citing the duty to disclose under Item 303 applies to material information only); Slater v. A.G. Edwards & Son, Inc., 719 F.3d 1190, 1197 (10th Cir. 2013) (citing *Litwin* for the holding that failure to comply with an SEC regulation *can* trigger liability under Section 11).

238. *See* Panther Partners Inc. v. Ikanos Commc'ns Inc., 681 F.3d 114, 120 (2d Cir. 2012) ("We hold that the [plaintiffs] plausibly alleges that the defect issue, and its potential impact on [defendant's] business, constituted a known trend or uncertainty that Ikanos reasonably expected would have a material unfavorable impact on revenues or income from continuing operations.").

239. *Id.* The court also made clear that Item 303's disclosure obligations were similar to materiality under the federal securities laws' anti-fraud provisions in that they "do not turn on restrictive mechanical or quantitative inquiries." *Id.* at 122.

240. *Id.* at 122.

241. *See id.* at 119–20 (explaining that Sections 11 and 12 impose liability for certain misstatements and misrepresentations).

The contrast between the reasoning in this line of 33 Securities Act cases and the parallel 10(b) decisions such as *Leidos* can be conveyed through the excerpts reviewed above. The gulf becomes stark, however, when the opinions are read as a whole. For example, none of the 33 Securities Act cases express agreement with *Oran*, which holds that Item 303 can give rise to Section 10(b) liability. Nor do any of the 33 Securities act cases note the driving principle of the Third Circuit's decision in *Oran*, which turns on the distinction between the materiality standard under Item 303 and *Basic*.[242] By contrast, all of the relevant 34 Exchange Act precedents leading up to *Leidos* include extensive discussions of the respective materiality standards, expressly adopt the position introduced by *Oran*, and make the distinction a central focus of the legal framework used in each case.[243] As a result, parallel sets of caselaw can be viewed as sorting themselves into two camps. While the 33 Securities Act cases are generally aligned with the conclusion that Item 303 violations function as a per se surrogate for claims under Sections 11 and 12,[244] the 34 Exchange act cases uniformly reach the conclusion that noncompliance with Item 303 may serve as a basis for Section 10(b) actions but only if certain further conditions are also met.

C. Resolving the Intra-Circuit Split over Item 303

The preceding discussion demonstrated that the parallel lines of cases that examine Item 303 reach divergent outcomes, depending on whether the underlying claims are based on Section 10(b) or Sections 11 and 12.[245] Whether the legal analyses behind those disparate approaches are sound is a separate question. One possibility, suggested in the vast majority of cases that have considered the issue, including *NVIDIA*, is that the two lines of

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242. Basic, Inc. v. Levinson, 485 U.S. 224 (1988).

243. *See, e.g.*, Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 100–04 (2d Cir. 2015) (discussing and comparing the standards under Item 303 and Section 10(b)).

244. The Livingston Opinion provides some mild confirmation on this point by lumping *Panther Partners* and *Litwin* with *Steckman*. *See id.* at 104 (discussing *Panther Partners*, *Litwin*, and *Steckman* all in the same context).

245. *See supra* Part IV.B (comparing Item 303 cases based on Section 10(b) claims with those based on Sections 11 and 12 claims).

cases simply call for entirely different analysis, rendering any intersection irrelevant. The alternative position, articulated primarily by Judge Livingston in *Stratte-McClure*, is that the same analysis must hold across these lines of cases.[246] If that is so, then it is not possible for all of these cases to have been rightly decided, given that they end up with different resolutions regarding Item 303's reach.

Judge Livingston appears to have a better argument on this point. She points out that Section 12(a)(2)'s requirement to disclose material omissions is "textually identical to that of Rule 10b-5."[247] Livingston's reasoning on Section 10(b) liability, therefore, is as follows: because the 33 Securities Act and 34 Exchange Act Sections have an identical materiality standard,[248] and because the 33 Securities Act cases hold that Item 303 omissions give rise to liability under those claims, it therefore follows that Item 303 also gives rise to liability under Section 10(b) of the 34 Exchange Act.

By comparison, the attempts to distinguish the various causes of action are less persuasive. *Steckman*, for example, states: "Section 10(b) . . . has only an implied right of action, differ[ing] significantly from Sections 11 and 12(a)(2) . . . which have express rights of action."[249] The *Oran* court also seemed to apply this distinction.[250] *Panther Partners* and *Litwin* also recite a litany of distinctions between 10b and Section 11 and 12 in the pleading

246. *See Stratte-McClure*, 776 F.3d at 104 (finding that Section 10(b) cases are relevant to Section 12 decisions).

247. *Id.*; *see also* 17 C.F.R. § 240.10b-5 (2017) (prohibiting deceptive practices in securities exchanges).

248. *See* Rombach v. Chang, 355 F.3d 164, 178 n.11 (2d Cir. 2004) ("The test for whether a statement is materially misleading under Section 12(a)(2) is identical to that under Section 10(b) and Section 11: whether representations, viewed as a whole, would have misled a reasonable investor.").

249. Steckman v. Hart Brewing, Inc., 143 F.3d 1293, 1296 (9th Cir. 1998).

250. *See* Oran v. Stafford, 226 F.3d 275, 288 n.9 (3d Cir. 2000)

> In *Steckman v. Hart Brewing, Inc.* . . . Ninth Circuit held that allegations which state a claim under SK-303 also sufficiently state a claim under Sections 11 and 12(a)(2) of the Securities Exchange (sic) Act. The court carefully limited its holding, however, making clear that it not extend to claims under Section 10(b) or Rule 10-b5. . . . Accordingly, *Steckman* does not support plaintiffs' claims here.

(internal citation omitted).

context.[251] *NVIDIA*, quoting *Steckman* and *Panther Partners*, stated that "Section 10(b) of the [34] Exchange Act . . . differs significantly from Sections 11 and 12(a)(2) of the [33] Securities Act for the following reasons: (1) liability under Sections 11 and 12 arises from an omission in contravention of an affirmative legal disclosure obligation,"[252] whereas there is "no such requirement" under Section 10(b) or Rule 10b-5;[253] and (2) Sections 11 and 12(a)(2) claims do not require proof of scienter, and therefore are not subject to heightened pleading standards.[254] Finally, and arguably most important, the *Leidos* Cert. Petition attempts to distinguish Section 10(b) from Section 11 only, conceding that the liability for Section 12(a)(2) is identical to Section 10(b), and likely indistinguishable.[255] The Cert. Petition notes that Section 11 imposes strict liability for omissions of material facts and, given that Congress easily could have changed that standard to match that of 12(a)(2) and 10(b), Section 11 cases should be handled differently.[256]

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251. *See* Panther Partners Inc. v. Ikanos Commc'ns Inc., 681 F.3d 114, 120 (2d Cir. 2012) (comparing Section 10b pleading standards with standards for Sections 11 and 12); Litwin v. Blackstone Grp., L.P., 634 F.3d 706, 715–16 (2d Cir. 2011) (examining the pleading requirements under Item 303 and Sections 11 and 12).

252. *In re* NVIDIA Corp. Sec. Litig.*,* 768 F.3d. 1046, 1055–56 (9th Cir. 2014) (internal quotation omitted).

253. *See id.* at 1056 (reiterating that "material information need not be disclosed unless omission of that information would cause other information that is disclosed to be misleading"). As Livingston points out, however, the Section 12(a)(2) standard instead is identical to that of Section 10(b). Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 104 (2d Cir. 2015) ("But Section 12(a)(2)'s prohibition on omissions is textually identical to that of Rule 10b-5.").

254. *See NVIDIA*, 768 F.3d. at 56 ("Furthermore, as noted in *Panther Partners,* scienter is not an element of either a Section 11 or Section 12(a)(2) claim. Such claims are not subject to the PSLRA's heightened pleading standards unless based on allegations of fraud." (internal citation omitted)).

255. *See Leidos* Cert. Pet., *supra* note 3, at 15 ("The distinction between Section 10(b) and Section 11 is crucial . . . .").

256. *See id.* at 15–16

> The absence in Section 10(b) of language imposing affirmative legal disclosure obligations[—]which was expressly included in Section 11[—]strongly suggests that Congress did not intend to impose disclosure liability under Section 10(b) for omissions based on regulatory disclosure obligations. . . . If Congress wanted to impose Section 10(b) liability for failing to disclose information required to be stated in SEC filings, it could have easily (and expressly) done so, just

The analytical gymnastics undertaken by these decisions evinces the judicial evasion of the central point: there is no relevant distinction between the requirements for claiming a material omission under Section 10(b), and Sections 11 and 12. A pleading standard is irrelevant; an implied versus express right of action is irrelevant; the liability threshold (after a material omission has been pled) is irrelevant. What is relevant, and an element of each of these claims, is that the omission be material. The logic presented above in Part II.B plays out here: Item 303 omissions can give rise to liability under Sections 10(b), and so too under Sections 11 and 12, provided that the *Basic* standard of materiality is met. The implication, therefore, is that *Steckman* and its progeny are incorrect. The broader irony inherent in the 33 Securities Act cases is that they manifest an intra-circuit split and expose the logical inconsistencies of the Section 10(b) cases.

D. The Missing Systemic Perspective on Securities Regulation

The logical inconsistencies that run through the case law analyzed above have implications that go beyond Item 303 and are relevant to much broader issues in securities law.[257] As the following discussion will argue, they are symptomatic of more general interpretative problems that are introduced by the unique legal structure and historical evolution of federal securities law.

A brief timeline of policymaking in securities law is sufficient to show that, despite a pattern of constant change, the one constant in that regulatory regime has been its overwhelming complexity. Starting with the New Deal Era, a central feature of federal securities regulation was that it developed in an extremely fragmented and piecemeal fashion.[258] After three decades of disorderly expansion,[259] the increasingly unwieldy nature of that

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as it had done the year before.

(internal citation omitted).

257. *See supra* Part IV.C (examining caselaw on Sections 10, 11, and 12).

258. *See* Dale Arthur Oesterle, *The Inexorable March Toward a Continuous Disclosure Requirement*, 20 CARDOZO L. REV. 135, 138 (1998) ("The United States federal government has grown its disclosure system from the bottom up, accumulating layers of specific statutes, regulations, rules, schedules, and items.").

259. The regulatory regime lacked a unified approach from its outset due to

process led to a shift in policymaking priorities that began in 1960s and 70s, which equated to a focus on reforms that could provide a more streamlined and cohesive system.[260]

By the 1980s, concrete progress was made toward a more integrated disclosure model, but those rules fell well short of providing a completely unified policy framework. The structure of securities regulation in its current form cobbles together elements from across each of these prior periods, and therefore encompasses an elaborate sprawl of legal authorities that are subtly interconnected along certain dimensions, yet function in isolation along others.[261]

The legal questions presented in *Leidos* and Item 303 cases potentially tee up some of the more intricate systemic relationships

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the bifurcated framework put in place by the 33 Securities Act and 34 Exchange Act. *See generally* Steve Thel, *The Original Conception of Section 10(b) of the Securities Exchange Act*, 42 STAN. L. REV. 385 (1990). The patchwork nature of disclosure requirements provided in those statutes was further exacerbated over the following decades, as the SEC issued an avalanche of formal and informal policy directives and a freewheeling body of judicial doctrines was spun out of the federal courts. *See* A.A. Sommer, Jr., *Securities Regulation By Louis Loss & Joel Seligman*, 46 BUS. LAW. 1895, 1895 (1991) (quoting contemporary accounts of the "staggering mass of material" that the SEC produced during the 1940s 50s, and 60s).

260. *See* Mary Jo White, The Path Forward on Disclosure, Speech at the Nat'l Assoc. Corp. Directors—Leadership Conference 2013 in National Harbor, Md. (Oct. 15, 2013) (summarizing the history of disclosure reform efforts). *See generally* Milton H. Cohen, *"Truth in Securities" Revisited*, 79 HARV. L. REV. 1340 (1966) (providing an influential call for a more integrated disclosure system). The landmark achievement to that end arrived in 1980, when the SEC established an integrated disclosure format pursuant to Reg. S-K. *See* SEC Reg. S-K Release (1977). *See also* Milton H. Cohen, *The Integrated Disclosure System: Unfinished Business*, 40 BUS. LAW. 987 (1985) [hereinafter Cohen, *Unfinished Business*]. *See generally* Edward F. Greene, *Integration of the Securities Act and the Exchange Act*, 3 J. COMP. CORP. L. & SEC. REG. 75 (1981). To a certain extent, disparate parts of the policy machinery were also stitched together by federal court decisions, for example in the consensus among circuit courts that an identical materiality standard that applies across the private causes of action under Section 10(b), Section 11, and Section 12.

261. *See* Roberta S. Karmel, *Disclosure Reform—the SEC is Riding Off in Two Directions at Once*, 71 BUS. LAW. 781, 787 (2016) ("[D]isclosure regulations have created an extremely complicated regime . . . disclosure polices . . . are [] scattered through SEC Forms, interpretative releases, no-action letters and comment letters on SEC filings, and have been articulated by the courts in a variety of securities cases."); *see also* Cohen, *Unfinished Business*, *supra* note 260, at 989 (discussing how securities regulation has changed over time).

in the securities regulation framework outlined above.[262] What stands out in those opinions, however, is how consistently they converge on a common strategy, which is to seize upon any available distinction that allows the legal materials to be examined as narrowly as possible. A good example is *Steckman*, a case regarding 33 Securities Act claims, wherein the Ninth Circuit declined to apply the reasoning of its 34 Exchange Act cases, without further explanation, after simply stating that the private right of action for Section 10(b) is implied, rather than express as in Sections 11 and 12.[263] Even that head-scratching non sequitur is more rigorous than the reasoning of some other decisions, however. Many cases do not bother to identify a particular point of comparison between the statutory provisions at issue, and instead invoke a blanket conclusion that the 33 Securities Act and 34 Exchange Act claims are simply different, in various ways.[264] The noteworthy aspect of these decisions is not that they are mistaken or unpersuasive; rather, it is that they do not reflect a credible effort to identify the relevant universe of legal authorities. In other words, the spurious distinctions that pop up from all corners in those cases are simply avoidance tactics, intended to preclude any confrontation with the more complicated aspects of the legal issues under analysis.

One objection to this characterization of the Item 303 cases is that they merely reflect the common judicial policy of only addressing legal issues that are strictly necessary to be reached. The problem is that, although that practice may be a prudent way to reduce legal error in many contexts, securities regulation presents a special case where this procedure may prove dysfunctional. In the securities law context, the interpretive challenge is to acquire a systemic perspective on the legal elements in question in order to determine whether any particular rule should be analyzed on its own terms or in conjunction with other

262. *See supra* notes 251–253 and accompanying text (providing opinions with different perspectives).

263. *See* Steckman v. Hart Brewing, Inc., 143 F.3d 1293, 1296 (9th Cir. 1998) (stating that the Exchange Act has an implied right of action).

264. *See supra* Part IV.C ("One possibility, suggested in the vast majority of cases that have considered the issue, including *NVIDIA*, is that the two lines of cases simply call for entirely different analysis, rendering any intersection irrelevant.").

authorities. A myopic view that begins by taking the disclosure rules in isolation, on the other hand, threatens to miss the forest for the trees, and a façade of judicial conservatism is likely to increase the incidence of legal error. Confirmation of these points is provided by the substantial misdirection of judicial resources that has taken place in Item 303 cases. The blinkered analyses in those decisions have culminated in the granting of Cert. in *Leidos*, where the Court has sacrificed its scarce docket space in order to resolve a line of precedents that are both legally sound and in full agreement; meanwhile, broad swaths of case law within the circuit courts that address similar issues have avoided scrutiny, despite the incompatible outcomes they produce.

The lackluster judicial performance in the Item 303 context conforms to a broader pattern of decisionmaking in securities law, which is documented in an important article by Stephen Bainbridge and Mitu Gulati.[265] In their paper, Bainbridge and Gulati provide an extensive catalogue of the rhetorical tools and doctrinal devices that allow federal judges to circumvent the complicated legal questions that often arise in securities litigation.[266] As a result, judges often dispose of securities fraud cases on the simplest grounds possible.[267] Bainbridge and Gulati argue that, although these judicial strategies are often defended on various grounds, the underlying policy rationales tend to be weak.[268] Instead, the doctrinal shortcuts they identify are better explained by a combination of judicial boredom with the technicalities of securities regulation, psychological aversion to complexity, and institutional constraints such as overcrowded dockets.[269] Bainbridge and Gulati mainly focus on shortcuts judges use when applying particular substantive legal standards, such as

265. *See generally* Bainbridge & Gulati, *supra* note 34. *But cf.* Donald C. Langevoort, *Are Judges Motivated to Create "Good" Securities Fraud Doctrine?*, 51 EMORY L. J. 309, 310 (2002) (arguing that the claims made by Bainbridge and Gulati are overstated in certain respects).

266. *See* Bainbridge & Gulati, *supra* note 34, at 91 (discussing the "doctrinal development" of the "Herculean model of adjudication," which "seeks to demonstrate that the rule is the economically efficient one").

267. *See id.* at 90 (arguing that judges often try to "dispose" of cases on simple threshold issues).

268. *See id.* (referring to this as a "systematic failure").

269. *See id.* (discussing the reasons for the practice of disposing of cases on the simplest grounds possible).

materiality or scienter,[270] but the same underlying logic fits the case law on Item 303 as well. The opinions in those cases reflect on an analogous set of analytical moves, which are used to reduce the complexity of legal authorities under consideration, and also tend to yield poorly reasoned results.

While it may be inevitable that generalist judges operating within the administrative constraints of federal courts will take a reductive approach to securities law cases, the problem is magnified by the fact that legal scholarship on securities regulation shares some of the same shortcomings. The primary culprit for this overly narrow perspective is a tendency of the literature to fixate on securities fraud claims under Rule 10b-5 to the exclusion of other regulatory policies or statutory provisions.[271] As with Bainbridge and Gulati's analysis of federal judges, there are a number of plausible theories for how the particular institutional incentives facing securities law professors may have skewed this scholarly output.[272] But regardless of the explanation,

270. *See id.* at 87 (stating that the analysis focuses on "materiality and scienter").

271. One clear manifestation of this is the crowded field of securities fraud topics in the literature, which often focus on debates concerning each particular element of a Section 10(b) fraud claim. *See generally* Anne M. Lipton, *Reviving Reliance*, 86 FORDHAM L. REV. 91 (2017); Donald Langevoort, *Reading* Stoneridge *Carefully: A Duty-Based Approach to Reliance and Third Party Liability Under Rule 10b-5*, 158 U. PA. L. REV. 2125 (2010); Jill E. Fisch, *Cause for Concern: Causation and the Federal Securities Fraud*, 94 IOWA L. REV. 811 (2008). Another generic problem appears in articles that approach topics exclusively from the perspective of Rule 10b-5, despite the applicability of the underlying questions to other areas of the securities law. *See generally* Bainbridge & Gulati, *supra* note 34 (arguing that judges avoid the technical details of securities fraud cases, but limiting its review of judicial decision-making to the relatively well understood doctrine relating to securities fraud cases); Langevoort & Gulati, *supra* note 36 (analyzing Item 303 cases with respect to 10b-5 but not Section 11 or Section 12).

272. Perhaps the most plausible explanation is that Rule 10b-5 securities fraud claims are the one area that may be familiar or of interest to outside audiences, who may regard the remainder of the field as tedious arcana. Bainbridge & Gulati, *supra* note 34, at 107 ("'High profile' and 'controversial' are almost never words used to describe securities class action cases."). A related reason is that the legal academy pays inordinate attention to the Supreme Court relative to its decisions' practical impact on the law, and Section 10(b) is the only section of the securities law that gets addressed by the Court with any regularity. *See* Donald C. Langevoort, *Words From on High About Rule 10b-5:* Chiarella*'s History,* Central Bank*'s Future*, 20 DEL. J. CORP. L. 865, 865 (1995) ("A securities law decision by the United States Supreme Court is an extraordinary event, especially when it deals with the centerpiece antifraud requirement, Rule

the practical result is that, in securities litigation cases presenting complex issues that strain the institutional capacity of federal courts, judges often cannot fall back on a body of scholarship that systematically clarifies how the dispute fits within the broader structure of securities regulation. *Leidos* once again provides a compelling illustration of this point, as the case has been widely misunderstood in academic commentary, which tends to dig no deeper than culling loose bits of language that the Cert. Petition pulls from decisions such as *Stratte-McClure*.

V. The Duty to Disclose

While the alleged dispute over Sections 11 and 12 precedents raises a number of puzzles of its own and carries significant implications that are not widely appreciated, the duty to disclose issue has received greater exposure in early commentary on *Leidos*, and has been the subject of greater scholarly attention in general. This section analyzes the duty to disclose as the second source of the *Leidos* mix-up. Part A begins by identifying how the duty to disclose issue has become a point of controversy in the relevant caselaw and scholarly commentary. Part B walks through the most prominent theory of how the duty to disclose doctrine should be interpreted in securities fraud cases relating to Item 303. It then explains why applying that analysis does not provide a useful framework for understanding the legal questions that are presented to the Court in *Leidos*. Part C closes by arguing that the confusion which the duty to disclose has generated in *Leidos* is typical of more general problems with the role that the doctrine plays in securities regulation.

10b-5."). A final factor may be that the continuous ebb-and-flow in the scope of securities fraud class actions provides a convenient platform for simplistic normative battles over whether securities law should be more "pro-defendant" or "pro-investor." *See, e.g.*, Franklin A. Gevurtz, *Law Upside Down: A Critical Essay on* Stoneridge Investment Partners, LLC, 103 NW. U. L. REV. COLLOQUY 448, 448–49 (2009) ("Given the current leaning of the Supreme Court, victory for the defendants in Stoneridge was probably predictable. Nevertheless, the decision is worth academic discussion because it illustrates how utterly irrational the law governing private securities fraud actions has become.").

A. Origins of the Leidos *Mixup over the Duty to Disclose*

The putative conflict in *Leidos* concerning the duty to disclose is raised at the outset of the Cert. Petition, which frames the question presented to the Court as the need to resolve a "direct conflict" among the circuit courts over the issue of "[w]hether . . . Item 303 of SEC Regulation S-K creates a *duty to disclose* that is actionable under Section 10(b)" of the 34 Exchange Act.[273] The Cert. Petition's primary basis for that claim is Judge Livingston's opinion in *Stratte-McClure*, which declares that it is "at odds" with the Ninth Circuit (*NVIDIA*) over the question of whether an Item 303 disclosure duty is actionable under Section 10(b).[274] The result is that commentary on *Leidos* is dominated by a working assumption that the Court must intervene in a judicial disagreement over the circumstances in which Item 303's requirements "trigger" a duty to disclose that gives rise to a Rule 10b-5 claim in securities fraud cases.[275]

The underlying source of that perspective can be traced, in part, to a seminal article on disclosure by Donald Langevoort and Mitu Gulati (L&G) entitled *The Muddled Duty to Disclose Under Rule 10b-5*.[276] The L&G article not only sets forth an influential interpretation of the specific legal question at issue in *Leidos*,[277] but has also had a relatively direct impact on the development of that case. In *Stratte-McClure*, the Livingston Opinion cites to L&G immediately before declaring a conflict between the Second and Ninth Circuits over the duty issue.[278] The certiorari briefing to the

273. *Leidos* Cert. Pet., *supra* note 3, at i (emphasis added).

274. Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 103 (2d Cir. 2015); *see also Leidos* Cert. Pet., *supra* note 3, at 2 (quoting the same passage from *Stratte-McClure*).

275. *See supra* note 20 (referencing sources that defend this proposition).

276. *See* Langevoort & Gulati, *supra* note 36, at 1640 (discussing the controversy surrounding the duty to disclose).

277. *See id.* at 1648 (discussing how the MD&A disclosures and Section 10(b) fraud claims interact). The L&G article is principally concerned with the interplay between the MD&A disclosures and a fraud claims under Section 10(b)). *Id.*

278. *See Stratte-McClure*, 776 F.3d at 102 ("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)." (citing Langevoort & Gulati, *supra* note 36, at 1640)).

Court refers to arguments contained in the L&G article, as well.[279] Thus, through a somewhat circuitous route, the origins of the alleged circuit split lies within L&G's theory of the duty to disclose.

As its title suggests, the main thrust of the L&G article is that there is a pervasive incoherence in judicial decisions that grapple with securities claims under Section 10(b) that are based on allegedly fraudulent *omissions*.[280] The L&G thesis proceeds from the premise that the "two central and required elements in any securities fraud case are materiality and a duty to disclose."[281] The source of the analytical muddle in securities fraud caselaw, they suggest, is a failure to maintain a clear conceptual distinction between those two elements.[282] In support of this argument, L&G point to the Third Circuit's decision in *Oran*, where then-Judge Alito's opinion is said to represent a leading "illustration of courts confusing duty and materiality."[283]

The line of reasoning that is filtered down from L&G and into *Leidos* is itself somewhat of a muddle in need of clarification. One issue is that, despite L&G's critique of *Oran*, Justice Alito's analysis in that case appears sound, and has been followed by other circuit courts that have considered the same issue.[284] Another wrinkle involves the Second Circuit's *Stratte-McClure* decision, which relies on both the Langevoort and Gulati article and the holding in *Oran* when announcing that its duty analysis is in conflict with that of the Ninth Circuit.[285] Because L&G argue that *Oran* was wrongly decided, however, the strange result is that the Livingston Opinion in *Stratte-McClure* wields a pair authorities against the Ninth Circuit that appear to contradict one

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279. Brief in Opposition to Petition for a Writ of Certiorari, *supra* note 19, at 20–21.

280. *See* Langevoort & Gulati, *supra* note 36, at 1647 (pointing out the disagreement regarding fraudulent omissions).

281. *Id.* at 1643.

282. *See id.* at 1650–51 ("In court opinions on the fraud question, it is often hard to determine whether the judge is basing her decision on materiality or duty.").

283. *Id.* at 1651.

284. *See supra* Part III.B.1 (discussing Justice Alito's opinion).

285. *See* Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 102 (2d Cir. 2015) ("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).").

another.[286] A final oddity is that, while the Second Circuit's decision in *Leidos* purports to follow *Stratte-McClure*, Judge Lohier's opinion in that case does not include more than a limited discussion of the duty issue and fails to note any tension with the Ninth Circuit's view of the doctrine.[287] Taken together, then, the caselaw and scholarship surrounding *Leidos* reflect a baffling crisscross of agreements and disagreements over the duty issue that calls for further explanation.

B. Clarifying the Duty to Disclose Under Item 303 and Rule 10b-5

In order to resolve the confusion over the duty to disclose that enters *Leidos* through Judge Livingston's reading of the L&G article, it is helpful to take a close look at the latter's argument, which begins with their definition of "duty."[288] On a first pass, L&G state that "duty . . . refers to whether there is an obligation to disclose a certain category of information."[289] "Materiality," by contrast, "refers to the matter of whether a piece of information would likely be important to the reasonable investor."[290] According to L&G, this conceptual distinction is critical, because determining whether a securities fraud defendant was subject to a duty to disclose is a freestanding part of the judicial inquiry in Section 10(b) claims, and one that necessarily precedes the question of materiality.[291]

When applying this framework, L&G conclude that Justice Alito's *Oran* opinion erred by not sequencing its reasoning into two

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286. *Compare id.* (citing both *Oran*, and Langevoort and Gulati favorably), *with* Langevoort & Gulati, *supra* note 36, at 1651 (referring to *Oran* as problematic).

287. *Supra* Part III.A.2.

288. *See* Langevoort & Gulati, *supra* note 36, at 1644 ("Duty, by contrast, refers to whether there is an obligation to disclose a certain category of information.").

289. *Id.* (citing COX ET AL., SECURITIES REGULATION § 10.4 (4th ed. 2004)).

290. *Id.*

291. *See id.* at 1643–44 ("Conceptually though, in order to provide a meaningful discussion about the duty question, we have to separate it carefully from the materiality question."); *see also id.* at 1644–45 ("[I]t is important to keep the two concepts separate . . . . Any suggestion that materiality and duty are the same would disturb [] foundational elements [of the securities regulation] architecture.").

separate steps. First, the analysis must begin by asking the "duty question," which "is simply whether violations of this particular category of disclosure requirements [here, Item 303] have the potential to mislead."[292] Second, if courts answer that initial question in the affirmative, they may "*then* go on to the question of whether the particular violation was material."[293] The L&G reading of *Oran* puts some meat on the bones of their otherwise vague articulation of how the duty to disclose doctrine applies in securities fraud cases. The two key moves are to equate the duty concept with a legal obligation to avoid statements that are misleading, and to anchor the source of those statements in the specific line item disclosures that the SEC requires firms to include in their public filings.[294]

1. Issues with the Conventional Analysis of Disclosure Duties for Rule 10b-5

Structuring the duty to disclose analysis as L&G suggest is problematic, however, because it obscures an important aspect of the legal obligation imposed by Rule 10b-5. Namely, a misleading line-item disclosure is neither sufficient nor necessary for a statement to be actionable under Section 10(b). As a consequence, the "category of information" which L&G argue is covered by the duty to disclose in the context of securities fraud claims is both under-inclusive and over-inclusive.

On one hand, focusing the duty question on violations of particular line-items such as Item 303 is too narrow, given that Rule 10b-5 forbids fraudulent statements in many contexts that do not involve the SEC's specific disclosure categories.[295] The presence of a line-item requirement is not a necessary precondition

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292. *Id.* at 1651.

293. *Id.*

294. A "line-item" is any content that is specifically required to be included in a firm's public filings under the SEC's disclosure rules. In addition to MD&A under Item 303, other examples include quantitative financial data under Reg. S-X, as well as qualitative information presented in narrative form on subjects such as "risk factors" facing a firm or summaries of any ongoing "legal proceedings."

295. *See* 17 C.F.R. § 240.10b-5 (2017) (providing a broad prohibition against fraud).

for a Section 10(b) claim for two reasons. First, securities fraud actions may be premised on deceptive statements that are made to investors in any form.[296] It is common for courts to recognize claims based on informal press releases or interviews by management that are published in the business press.[297] Second, even in the context of disclosures filed with the SEC, a Rule 10b-5 claim can be supported by the omission of information that does not correspond to any particular line-item requirement. One notable illustration of this point is a recent series of class actions against companies such as Target, Inc., which turned on the alleged failure to disclose internal cybersecurity protocols.[298] The same conclusion also follows from a widely recognized purpose of Rule 10b-5, which is for Section 10(b) to serve as a "catch-all" provision that covers interstitial categories of information that have not been explicitly designated by the SEC.[299]

On the other hand, defining the duty inquiry as a question of whether a line-item disclosure (or any other statement) is

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296. *See, e.g.*, Beaver Cnty. Emps.' Ret. Fund v. Tile Shop Holdings, Inc., 94 F. Supp. 3d 1035, 424, 426 (D. Minn. 2015) (reasoning that press releases and other public statements [such as WSJ interviews] actionable under 10b if materially misleading (citing *Shaw* and other 1st Circuit cases)); *see also* Karmel, *supra* note 261, at 786 ("The line-item disclosures of Regulation S-K are mandated and do not depend on an independent judgment by registrants as to their materiality."). In fact, there does not even need to be a statement. As the Court has recently held, *actions* taken by management can be deceptive under Rule 10b-5 as well. *See* Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148, 158 (2008) (finding no need even for a statement: "If this conclusion were read to suggest there must be a specific oral or written statement before there could be liability under § 10(b) or Rule 10b–5, it would be erroneous. Conduct itself can be deceptive, as respondents concede").

297. In other words, although the SEC does not provide line item categories of information that a CEO must disclose during an interview with the *Wall Street Journal*, investors may nonetheless sue under Section 10(b) if her responses to the reporter are deceptive due to the fact that they leave out certain pieces of relevant information.

298. The nondisclosure of cyber-security threats that were the basis for fraud actions against Target and other companies took place before the SEC had issued any guidance as to whether or where those topics must be included in a firm's periodic filings *See* Karmel, *supra* note 261, at 812 (discussing the Target "debacle" and "other high-profile cybersecurity breaches").

299. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 202, 206 (1976) ("The section was described rightly as a 'catchall' clause."). If this were not the case, there would effectively be immunity for any nondisclosure, no matter how deceptive, so long as it does not violate a specific requirement in the securities regulations.

"misleading" creates a legal obligation that is too broad. This is because many line-item rules deal with technicalities that can be stated in a misleading manner yet still not provide any plausible basis for fraud claims, due to their lack of materiality.[300] For example, Item 102 of Reg. S-K requires that companies list the address of all physical properties owned by the parent entity or its subsidiaries; Item 502, meanwhile, mandates that a table of contents follow after the cover page of any prospectus document.[301] As these rules suggest, certain SEC line item rules and other corners of the securities regulation regime compel the production of trivial bits of information. Rule 10b-5, by contrast, does not do so, and leaves firms free to remain silent with regard to immaterial facts which, if disclosed, would remedy inaccuracies in representations that are only of marginal importance.[302]

While the foregoing examples highlight the potential blind spots in L&G's conception of the duty to disclose at a relatively granular level, the same general oversights are also evident in light of the plain language of Rule 10b-5. In relevant part, the rule provides that it is "unlawful" to make "any untrue statement of material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances

300. *See* Langevoort & Gulati, *supra* note 36, at 1645 n.18 ("Although the rationale for the construction of the various disclosure obligations of companies—such as their periodic filing obligations in Forms 10-Q and 10-K—is that the information is likely to be important to investors, not every piece of information required is going to be important in every instance.").

301. *See* Item 102, 17 C.F.R. § 229.102 (2017) ("State briefly the location and general character of the . . . physical properties of the registrant and its subsidiaries."); Item 502, 17 C.F.R. § 229.502 ("You must include the table of contents immediately following the cover page in any prospectus you deliver electronically"; also including front and back page formatting requirements.").

302. A table of contents can be designed in a way that flouts the formatting strictures of Item 502 while also giving a false impression of the contents in a prospectus, but nonetheless fail to defraud investors. *Cf.* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 38 (2011) ("We were 'careful not to set too low a standard of materiality,' for fear that management would 'bury the shareholders in an avalanche of trivial information.'" (quoting Basic, Inc. v. Levinson, 485 U.S. 224 (1988); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976)); Greenhouse v. MCG Capital Corp., 392 F.3d 650, 656 (4th Cir. 2004) (stating that Section 10(b) and Rule 10b-5 "decidedly do not prohibit any misrepresentation—no matter how willful, objectionable, or flatly false—of immaterial fact, even if it induces reactions from investors that, in hindsight or otherwise, might make the misrepresentations appear material").

under which they were made, not misleading."[303] Two features characterize the information that Section 10(b) creates a legal obligation to disclose. First, the omitted information can relate to "any statement."[304] This is consistent with preceding observation that, depending on the particular statements at issue in a case, an omission may be actionable even if it is unrelated to a line item category of information.[305] Second, the omitted information must render a statement materially misleading in order to be actionable as a Section 10(b) claim.[306] The key implication here, which also confirms the intuition suggested above, is that Rule 10b-5 can only be violated by the joint presence of both conditions in the same statement (an omission that is misleading as well as material).[307] Therefore, any definition of duty that walls off the question of materiality is incomplete.[308]

Once the universe of information covered by Rule 10b-5 is reframed along these lines, the alleged circuit splits and accusations of legal error that swirl around *Leidos* dissolve away. This includes the L&G critique of the Third Circuit's duty analysis in *Oran* which, upon reexamination, falls short for a number of reasons.[309] First, once L&G's insistence on the strict separation

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303. 17 C.F.R. § 240.10b-5(b).

304. *See id.* (stating that it is illegal to make "any untrue statement of a material fact").

305. *See* Langevoort & Gulati, *supra* note 36, at 1647 (discussing the treatment of fraudulent omissions).

306. *See id.* at 1644 (discussing the materiality requirement).

307. In other words, investors have no securities fraud claim against firms that issue statements that withhold material information so long as they are not deceptive; neither can they sue firms that issue statements that are misleading if they are immaterial. *See* David Monsma & Timothy Olson, *Muddling Through Counterfactual Materiality and Divergent Disclosure*, 26 STAN. ENVTL. L.J. 137, 168–72 (2007) (providing an argument to the same effect); Victor Brudney, *A Note on Materiality and Soft Information Under the Federal Securities Laws,* 75 VA. L. REV. 723, 726 n.10 (1989) (same); Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763, 816–25 (1995) (same).

308. Reframing the duty to disclose in this manner does not entail a conflation of misleading omissions with material omissions, as one reading of L&G might suggest. Identifying the conjunction of two sets does not eliminate the distinct conceptual properties that define each set.

309. Recall, the criticism was that then-Judge Alito's opinion improperly skipped over the duty issue, because it found that the omissions alleged by the *Oran* plaintiffs were immaterial but did not first determine whether they were misleading. *See supra* notes 291–292 and accompanying text (stating that

between misleading and material omissions is dropped, it is not obvious that Justice Alito's opinion actually passed over the duty question. Instead, a more plausible reading of *Oran* is that such a determination was implicit in the materiality analysis.[310] Second, because Rule 10b-5 can be violated only by statements that are misleading in a material way, a finding that either condition is absent will be sufficient to dispose of a claim under Section 10(b).[311] Therefore, even if the *Oran* opinion skipped over L&G's narrow version of the duty question, the court was not logically required to resolve that question in the first place. Third, there is no merit to an objection on sequencing grounds.[312] In Section 10(b) claims, materiality is considered a mixed question of law and fact, which means that it can properly be reached at the motion to dismiss stage in order to sustain a finding that the pleadings are insufficient as a matter of law.[313] In short, the argument that Justice Alito's opinion fumbled the duty issue does not hold up; and by extension, neither does the stronger claim that *Oran* illustrates a broader analytical disarray in the caselaw relating to Item 303 and Section 10(b).

Likewise, the purported split between the Second and Ninth Circuits only gains traction when a convoluted theory of the duty issue is applied. Here, the decisive passage comes from the Second Circuit decision in *Stratte-McClure*, wherein the court notes that

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materiality analyzes whether the particular piece of information would be important to the reasonable investor).

310. "Materiality" is a concept that deals with magnitudes—it concerns *how* misleading a statement or omission is. A close analysis of something's magnitude often presupposes that it exists. *See* Langevoort & Gulati, *supra* note 36, at 1644 ("Materiality refers to the matter of whether a piece of information would likely be important to the reasonable investor.").

311. *See id.* at 1644 (describing materiality as a "central and required" element).

312. In other words, the idea that although the materiality element may be dispositive on an ultimate finding of liability may not precede the duty question when a court is asking whether a claim has been stated.

313. This was precisely what was done by the district court decision that was upheld in *Oran*. In fact, courts often bypass both the misleading or material addressing the question of scienter, which is expressly authorized under terms of the PSLRA. *See, e.g.*, Thompson v. RelationServe Media, Inc., 610 F.3d 628, 633 n.11 (11th Cir. 2010) (upholding dismissal of 10b-5 claim based on failure to plead scienter under PSLRA, without reaching other elements of the claim); *In re* NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1056 (9th Cir. 2014) (dismissing Rule 10b-5 claim on scienter grounds).

noncompliance with Item 303 *may* involve a misleading statement that is relevant for purposes of a Section 10(b) claim.[314] There are two potential interpretations of this language. From one perspective, it is an accurate yet entirely innocuous proposition. As has been explained, "any statement" can be misleading for purposes of Rule 10b-5, and Item 303 do not represent a special exception from the general rule that gives MD&A disclosures some sort of safe harbor immunity against the prohibition on securities fraud.[315] In other words, the Second Circuit is restating a truism. Under the L&G framework, by contrast, the same passage in *Stratte-McClure* represents the court's resolution of the duty issue. It therefore addresses a mandatory threshold question, and directs the decision in that case down a path that will differ from others which do not perform a similar analysis. Because the Livingston Opinion self-consciously adopts the L&G approach, it misconstrues the opinion in *NVIDIA* and sets the Second Circuit "at odds" with a conclusion that no court, including the Ninth Circuit, has ever asserted.[316]

314. *See* Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 102 (2d Cir. 2015) ("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)."); *see also* Langevoort & Gulati, *supra* note 36, at 1645 n.19 (discussing the when omission of certain facts may or may not be misleading).

315. Materially misleading omissions will often involve noncompliance with a line-item requirement, even though the latter is not necessarily required. For one, the SEC presumably formulates most disclosure rules in order to cover information that is likely to be of interest to investors. *See* Shaw v. Dig. Equip. Corp., 82 F.3d 1194, 1202 (1st Cir. 1996) ("The obligations that attend the preparation of [a registration statement and prospectus] embody nothing if not an affirmative duty to disclose a broad range of material information."); *see also* Langevoort & Gulati, *supra* note 36, at 1645 n.18 (explaining that, although the purpose of disclosure obligations is to inform investors, not all disclosed information will always be important). In addition, the fact that the SEC requires certain information in a line-item may also lead to self-fulfilling expectations on part of investors that such information will be produced. *See* Oesterle, *supra* note 258, at 146 (referring to the "self-enforcing" nature of judicial interpretations of SEC line items rules).

316. *See supra* Part III.B.1 (discussing the *Leidos* case's cert. petition argument regarding a circuit split on the issue presented by *Leidos*).

2. Reframing the Relationship Between Item 303 and Section 10(b)

The duty to disclose rhetoric that appears in *Leidos* does more than encourage some questionable interpretations of the relevant precedents. It also distorts the bigger picture perspective on securities fraud claims that involve MD&A disclosures. The prevailing view seems to be that violation of Item 303 effectively serves as a predicate act, which courts must identify in order to determine whether a viable Section 10(b) claim has been pled.[317] In reality, there is no particular legal relationship between Rule 10b-5 and Item 303 beyond the fact that both regulations happen to obligate disclosures that look similar in many respects but are not identical.

A notable example, of course, is the rules' respective materiality standards.[318] But close parallels appear along a number of other dimensions as well: Section 10(b) and Item 303 have roughly comparable knowledge requirements;[319] both attempt to draw a distinction between disclosure of verifiable historical facts, as opposed to expressions of opinion or forward-looking projections;[320] and, they may both apply to the

317. *See supra* Part III.B.2 (discussing the relationship between a violation of Item 303 and a Section 10(b) claim through discussion of the *Leidos* case).

318. *See supra* Part II.C (discussing materiality in the context of disclosure requirements).

319. The scienter standard in Item 303 turns on language that requires the disclosure of "known facts." *See* 17 C.F.R. § 229.303 (2017) (providing Item 303 rules which includes language requiring identification or descriptions of "any known trends"). Meanwhile, the scienter standard for fraud claims is generally understood to be recklessness rather than actual knowledge. *See* Tellabs, Inc. v. Makor Issues & Rights, 551 U.S. 308, 319 n.3 (2007) (discussing the court of appeals' decisions allowing the scienter requirement to be met by showing recklessness on the part of the defendant).

320. *See In re* Verifone Sec. Litig., 11 F.3d 865, 870–71 (9th Cir. 1993) (stating that there is no rule 10b-5 liability for purely forward-looking statements); Eisenstadt v. Centel Corp., 113 F.3d 738, 745–46 (7th Cir. 1997) (explaining that Rule 10b-5 does not apply to statements of opinion that amount to mere puffery); DiLeo v. Ernst & Young, 901 F.2d 624, 627 (7th Cir. 1990) (explaining that Rule 10b-5 does not apply to speculative statements that are only false when viewed in hindsight). *Compare* SEC Rule 175, 17 CFR § 230.175 (providing Rule 10b-5 safe harbor for forward-looking statements), *with* SEC 1989 Release, *supra* note 73 (providing analogous rule for purposes of Item 303).

same underlying disclosure documents.[321] In any particular case, courts may compare these categories side-by-side, and where they find the overlap to be complete, declare that Item 303 has "triggered" a Rule 10b-5 cause of action. But no such procedure is required—the elements of Section 10(b) stand by themselves, and a motion to dismiss must be denied whenever a claim has been properly stated under the terms of the Private Securities Litigation Reform Act.[322] For this reason, the underlying complaints in *Leidos* span hundreds of pages, but only mention Item 303 in a few stray paragraphs, if at all.[323] Indeed, as one practitioner has explained, the inclusion of Item 303 allegations in a securities fraud complaint is often considered a minor drafting point or throwaway formality.[324]

The misunderstood legal relationship between Item 303 and Rule 10b-5 has led commentators to overstate the effect that particular interpretive decisions in the federal courts may have on actual outcomes in securities litigation.[325] Even if the caselaw draws subtle technical distinctions between the relevant standards of Item 303 and Rule 10b-5 (regarding materiality, scienter, and so on), it is hard to envision a real-life fact pattern that would occupy

321. This is because Rule 10b-5 claims can be premised on statements made in SEC filings in which Item 303 disclosures must appear. *See Shaw*, 82 F.3d at 1222 (discussing that Rule 10b-5 claim can proceed based on statements made in prospectuses and registration statements, in addition to periodic financial statements made on a quarterly and annual basis).

322. *See* Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended at scattered sections of 15 U.S.C.) (providing for dismissal if the pleadings in an action under the statute do not meet all requirements set out under the statute).

323. *See generally* Compl., *supra* note 117 (failing to mention Item 303). *See* Am. Compl., *supra* note 107, ¶¶ 49–50 (referencing Item 303 in 2 out of 165 paragraphs). Likely in response to the Second Circuit and SDNY's unexpected focus on the Item 303 issue, there is a slight uptick in its use in the Second Amended Complaint. *See* Second Am. Compl., *supra* note 138, ¶¶ 5, 13, 403, 444, 445, 475, 492 (referencing Item 303 in seven of 527 paragraphs).

324. *See* Douglas W. Greene, *Why Item 303 Just Doesn't Matter In Securities Litigation*, LAW360 (Oct. 13, 2015, 12:49 PM), https://www.law360.com/articles/711040/why-item-303-just-doesn-t-matter-in-securities-litigation (last visited Jan. 17, 2018) (arguing that Item 303 lacks value as a practical matter) (on file with the Washington and Lee Law Review).

325. *See supra* Part II (discussing the commentary surrounding the Item 303 and Section 10(b) relationship and the several cases, specifically *Leidos*, that have dealt with this relationship).

the interstitial gap between the two sets of requirements. In other words, as a practical matter, an omitted fact that violates Item 303 will almost always render a statement materially misleading for purposes of a fraud claim as well.[326] This reality belies claims made by the Cert. Petition that recent circuit court opinions, such as *NVIDIA* and *Stratte-McClure*, have spurred rampant forum shopping by plaintiff's attorneys in securities class actions.[327] It also means that, for securities plaintiffs who would prefer that noncompliance with Item 303 automatically translate into a Section 10(b) claim in some mechanical *per se* fashion, not much will be at stake in how the Court decides *Leidos*.

A final irony of the duty to disclose debate in *Leidos*, lost on most of the briefing to the Court and academic commentary, is that the presence of a legal obligation to disclose information relating to MD&A is quite literally not at issue in the case. It is uncontested that such a requirement is imposed by the SEC through Item 303 of Reg. S-K. In the rare (but hypothetically possible) case where factual allegations that support a violation of Item 303 do not also give rise to a fraud claim under Rule 10b-5, the only upshot is that a private enforcement mechanism for that requirement is unavailable.[328] The SEC can still police noncompliance with its MD&A rules through cease-and-desist orders and other forms of regulatory supervision.[329] Thus, from a policy perspective that focuses on the flow of information to capital markets, the kinds of disclosures that the securities regulations compel firms to make to investors will remain unchanged.

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326. No decision in the caselaw surrounding *Leidos* finds material noncompliance with Item 303 in a way that did not also support a fraud claim, on the grounds that the underlying facts were immaterial as matter of law under *Basic*.

327. *See Leidos* Cert. Pet., *supra* note 3, at 17 (arguing that securities plaintiffs have rushed from the Ninth Circuit to the Second Circuit in recent years).

328. *Cf.* Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2208 (2010) (arguing that overlapping public and private enforcement is an inefficient way to prevent securities fraud).

329. *See supra* Part II.B (discussing the SEC's power to exercise enforcement authority over disclosure requirements violations).

C. The Role of the Duty to Disclose in Securities Regulation

Debate over the precise meaning of the duty to disclose doctrine permeates the securities regulation caselaw and has inspired a voluminous body of legal scholarship.[330] These disputes first gained momentum in the seminal insider trading case of 1980, *Chiarella v. United States*,[331] where the Court stated that "when an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak."[332] Although the law of insider trading generally concerns a set of conduct and legal theories that is foreign to securities fraud suits based on misleading corporate disclosures,[333] the duty language from *Chiarella* migrated over to the conventional fraud context with the Court's 1988 opinion in *Basic*, where it held that "[s]ilence, absent a duty to disclose, is not

330. *See generally* Oesterle, *supra* note 258 (discussing the meaning of the term "material" in securities law); Monsma & Olson, *supra* note 307, at 168–72 (arguing that firms cannot be sued for issuing statements that are misleading if they are immaterial); Kitch, *supra* note 307, at 816–25 (same); Jeffrey D. Bauman, *Rule 10b-5 and the Corporation's Affirmative Duty to Disclose*, 67 GEO. L.J. 935, 936 (1979) ("The extent to which rule 10b-5 imposes a duty to disclose in the absence of trading or prior inaccurate disclosure, however, remains relatively undefined."); Alan L. Talesnick, *Corporate Silence and Rule 10b-5: Does a Publicly Held Corporation Have an Affirmative Obligation to Disclose?*, 49 DENV. U. L.J. 369, 370 (1972) (discussing "material information" and asking under what circumstances a corporation has an obligation to disclose such information).

331. 445 U.S. 222 (1980); *see* Langevoort & Gulati, *supra* note 36, at 1641 ("Ever since [the decision in *Chiarella*], the lower courts have struggled to make sense of what the Court meant [in that case regarding the duty to disclose]."); *cf.* Hugh T. Wilkinson, *The Affirmative Duty to Disclose After* Chiarella *and* Dirks, 10 J. CORP. L. 581, 598 (1984) (arguing that the decisions issued after *Chiarella* indicate that "the affirmative duty to disclose retains vitality, and indeed, it remains a rather expansive doctrine").

332. *Chiarella*, 445 U.S. at 230.

333. While insider trading cases are premised on Section 10(b), the federal courts did not recognize such claims until more than two decades after Rule 10b-5 was promulgated. *See In re* Cady, Roberts & Co., Exchange Act Release No. 8-3925, 49 SEC Docket 907, at *3–5 (Nov. 8, 1961) (recognizing federal insider trading claims through SEC administrative action); SEC v. Tex. Gulf Sulphur Co., 401 F.2d 833, 848–49 (2d Cir. 1968) (adopting the SEC position), *cert. denied*, 394 U.S. 976 (1969); *see also* STEPHEN M. BAINBRIDGE, THE LAW AND ECONOMICS OF INSIDER TRADING: A COMPREHENSIVE PRIMER 9–12 (2001), http://pages.stern.nyu.edu/~jhasbrou/Teaching/POST%202015%20Fall/Materials/SSRN-id261277.pdf (reviewing the origins of the federal prohibition on insider trading).

misleading."[334] The way that the duty to disclose has been conceived in *Leidos* is typical of a broader theoretical approach to the issue, and is therefore revealing of some of the more dysfunctional aspects that apply to those debates in general.

The L&G analysis is a useful starting point in this respect, as it once again provides the clearest articulation of the duty analysis that is adopted in much of the relevant caselaw and broader commentary on the case. L&G define the parameters of any proper theory of the duty to disclose by explaining that it must be consistent with the "two foundation stones in the securities disclosure architecture."[335] Those are that: "First, not all material information has to be disclosed [and] [s]econd, immaterial information is often required to be disclosed (although not under Rule 10b-5)."[336] The otherwise subtle parenthetical regarding Rule 10b-5 holds the key to this argument—why should a definition of the legal obligation to disclose information under Rule 10b-5 turn on requirements that are nowhere provided in that regulation but instead belong to other areas of the securities law? The unstated assumption here is that the "duty to disclose" is a unified principle that must be derived from a comprehensive view of the securities law "architecture" as a whole. This is a fairly representative view. A hallmark of the judicial and scholarly response to *Chiarella* and *Basic* is to take the Court's language at face value by seeking to define a duty to disclose in the abstract, and then resolve particular legal questions in a way that fits with the underlying logic of the more general concept.[337]

A broader lesson of this article's analysis is that the leading approach to the duty question runs into serious theoretical and practical difficulties. The most obvious problem is that it produces poor results. As employed in *Leidos*, the relevant conceptual categories do not map well onto the interaction between Item 303 and Section 10(b), do not provide persuasive critiques of the

334. *See* Basic, Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988) (discussing the requirement that a statement be misleading to be actionable).

335. Langevoort & Gulati, *supra* note 36, at 1644–45.

336. *Id.*

337. *See* Bauman, *supra* note 330, at 949 (discussing that there are ways to inform corporations how to act while providing courts with information to determine good faith efforts to comply with the duty to disclose given uncertainties in duty to disclose requirements).

relevant caselaw, and often draw attention to sources of disagreement that are nonexistent or merely superficial. In other words, *Leidos* illustrates the hazards of tackling the duty question based on principles by showing how such an analysis can quickly make an easy case seem very hard.

An alternative to the abstract conception of the duty to disclose has been provided in the analysis of Section 10(b) and Item 303 that is presented directly above.[338] The basic procedure is to determine the timing and content of any given disclosure duty by grounding the question in the specific legal authorities at issue—whether they be statutory provisions, regulatory rules, statements in the legislative history, or interpretive guidance released by the SEC. This framework differs from that of L&G and the Second Circuit's Livingston Opinion in that it treats duty as a localized concept that varies across different portions of the securities regulation architecture, rather than as a metaphysical object which hovers above it.[339] The advantage of a more particularized approach to duty is that it can reduce apparently complicated legal or policy questions into much simpler terms, and highlights the fact that "[t]o focus on a duty to disclose in the abstract . . . would be to miss the obvious in favor of the obscure."[340]

The deeper theoretical weakness of an abstract approach to the duty to disclose question relates to an equivocation over the term "duty" as it is used in securities law. In the insider trading context, the duty to "speak" mainly reflected a prohibition on certain kinds of securities transactions, and had little to do with

338. *See supra* Part V.B.2 (comparing the standards, rules, and requirements of Item 303 and Section 10(b) violations and claims under each cause of action).

339. *See* Neach, *supra* note 6, at 757 ("A detailed look at the various liability provision that a novel concept—reading the statutes and rules themselves—can help to clear at least some of the confusion [relating to Item 303]."); *see also* Gallagher v. Abbott Laboratories, 269 F.3d 806, 807–11 (7th Cir. 2001) (detailing the universe of regulatory mandates for disclosure). *But cf.* Donald C. Langevoort, *Half-Truths: Protecting Mistaken Inferences by Investors and Others*, 52 STAN. L. REV. 87, 125 (1999) (questioning whether securities regulation framework provides sufficient guidance regarding when disclosures must be made on a continuous rather than periodic basis).

340. *See* Shaw v. Dig. Equip. Corp., 82 F.3d 1194, 1202 (1st Cir. 1996) (explaining that the main issue in the case is not whether there was an abstract duty to disclose but whether there was a specific obligation to disclose the relevant information).

financial disclosures per se.[341] Instead, when *Chiarella* and related insider trading precedents invoked the duty concept, those courts were referring to the state law of fiduciary duties that applied to corporate officers and certain other employees as agents of a corporation, and grafting those fiduciary obligations onto the federal securities law.[342] Thus, the "duty" was employed as a term of art that was borrowed from the common law of agency, tort, or contract.[343] As such, the term mapped onto the common law idea that heightened legal duties could arise from the presence of certain special relationships.[344]

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341. *See* BAINBRIDGE, *supra* note 333, at 43 (arguing that it is the act of insider trading rather than nondisclosure which provides the basis for imposing liability); Charles C. Cox & Kevin S. Fogarty, *Bases of Insider Trading Law*, 49 OHIO ST. L.J. 353, 353 (1988) (discussing the abstention versus disclosure view of insider trading).

342. *See* RESTATEMENT (SECOND) OF AGENCY § 395 (AM. LAW INST. 1958) (discussing the duty of confidentiality for corporate agents); *see also* BAINBRIDGE, *supra* note 333, at 39–40 (discussing state law's influence on federal law in fiduciary duty and insider trading questions); Langevoort & Gulati, *supra* note 36, at 1654–55 (discussing the Supreme Court's intrusion into state fiduciary law in *Chiarella*); Theresa A. Gabaldon, *State Answers to Federal Questions: The Common Law of Federal Securities Regulation*, 20 J. CORP. L. 155, 157 (1994) (discussing the Supreme Court's use of state law to decide federal cases).

343. *See* Ronald C. Wyse, *A Framework of Analysis for the Law of Agency*, 40 MONT. L. REV. 31, 32–33 (1979) (explaining the distinction between the common law of agency, tort, and contract); Sheldon Gardner & Robert Kuehl, *Acquiring an Historical Understanding of Duties to Disclose, Fraud, and Warranties*, 104 COM. L.J. 168, 179–88 (1999) (discussing disclosure requirements under the various bodies of common law).

344. The duty question also had unique significance as a procedural matter. In the common law tort of negligence, for example, the duty determination was understood to enjoy lexical priority over other steps in the judicial analysis, because it was considered a pure question of law. Other elements of a negligence claim—such as breach, materiality, and reliance—were usually framed as raising pure questions of fact and therefore not properly resolved at the pleading stage. *See* John C.P. Goldberg & Benjamin C. Zipursky, *The Restatement (Third) and the Place of Duty in Negligence Law*, 54 VAND. L. REV. 657, 667–68 n.38 (2001) (discussing the potential procedural differences between two formulations of negligence, one which includes and one which does not include reference to duty); Keith N. Hylton, *Duty in Tort Law: An Economic Approach*, 75 FORDHAM L. REV. 1501, 1501 (2007) (arguing that an economic analysis can explain the concept of duty and provide a theory of tort law). Securities fraud actions have at times been analogized to common law fraud, a tort historically known as "deceit." *See* Steven A. Fishman, *Duty to Disclose Under Rule 10b-5 in Face-to Face Transaction*, 12 J. CORP. L. 251, 262 n.79 (1986) (comparing state common law and federal securities law with respect to liability for nondisclosures). However, duty was not an element of those claims at common law, because deceit was an intentional tort,

By contrast, when courts refer to duty in the context of private securities class actions alleging wrongful nondisclosures, the term does not carry the same common law implications.[345] Instead, "duty" functions as a synonym for whatever legal "requirement," "mandate," or "obligation" is established under the particular statutory or regulatory authority that a plaintiff has invoked as a cause of action in that case. In other words, for determining the applicability of disclosure requirements in the securities laws—*the only function of which is to legally obligate the disclosure of information*—an invocation of the duty to disclose is a tautological formulation that does not serve an independent role in the legal analysis.[346] As illustrated in *Leidos*, the main stumbling block in

like battery, and therefore did not require a plaintiff to plead any particular relationships to the defendant. *See* RESTATEMENT (SECOND) OF TORTS § 525 (AM. LAW INST. 1977) (providing the elements required to impose liability for fraudulent misrepresentations); *see also* Gregory Klass, *Meaning, Purpose, and Cause in the Law of Deception*, 100 GEO. L.J. 449, 454 (2012) (providing the elements of a claim of deceit which does not include a duty or relationship requirement); Paula J. Dalley, *The Law of Deceit, 1790–1860: Continuity Amidst Change*, 39 AM. J. LEGAL HIST. 405, 407–08 (1995) (same). For that reason, the "half-truth doctrine"—which provides a cause of action under common law fraud for alleged omissions—does not implicate the "duty" element which otherwise forms a part of claims in connection with unintentional torts, at least not as it is traditionally understood.

345. *See* Omnicare v. Laborers Dist. Council Constr. Pension Fund, 135 S. Ct. 1318, 1330 n.9 (2015) (explaining that Section 11 is "not coextensive with common-law doctrines of fraud"); Stoneridge Inv. Partners v. Scientific-Atlanta, Inc., 552 U.S. 148, 162 (2008) ("Section 10(b) does not incorporate common-law fraud into federal law."); *see also* Herman & MacLean v. Huddleston, 459 U. S. 375, 381, 388–89 (1983) (explaining that one of the purposes of federal securities laws was to address and fix issues found in the common law); *cf.* Edward A. Fallone, *Section 10(B) and the Vagaries of Federal Common Law*, 1997 ILL. L. REV. 71, 104 ("Although it is difficult to find a consistent pattern in the Court's approach to definite the elements relevant to a 10b-5 action, one recurring theme has been the occasional judicial relaxation of elements drawn from the common law of fraud."); Margaret V. Sachs, *The Relevance of Tort Law Doctrines to Rule 10b-5: Should Careless Plaintiffs be Denied Recovery?*, 71 CORNELL L. REV. 96, 137 (1985) ("The Supreme Court has accorded common law deceit a limited role in interpreting rule 10b-5 . . . . The Court has disregarded common law deceit principles where the statute's language, history, structure, or policy are dispositive.").

346. Although this circularity is acknowledged in pockets of the scholarly literature, it is usually noted in passing, and treated as a peculiar yet harmless framing mechanism which courts recite before introducing their substantive analysis. *See, e.g.*, Robert H. Rosenblum, *An Issuer's Duty Under Rule 10b-5 to Correct and Update Materially Misleading Statements*, 40 CATHOLIC U. L. REV. 289, 293 (1991) (calling the standard tests for when there is a duty to disclose

taking an abstract approach to the duty to disclose is that, by freighting the duty analysis with significance that it does not have, courts and scholars lose sight of the disclosures which are compelled by the legal authorities that are actually on point.

VI. Conclusion

By taking up *Leidos* for its October 2017 Term, the Court put itself on course to address a set of statutory and regulatory authorities that are at the heart of the securities law framework. As this article has argued, however, even before its settlement, *Leidos* did not present the Court with an opportunity for resolving any split among the circuit courts of appeals as to how the relationship between those authorities should be interpreted. The consensus in the caselaw is that a failure to comply with the MD&A disclosure requirements in Item 303 of Reg. S-K may in many circumstances also constitute an actionable claim for securities fraud under Rule 10b-5,[347] but it does not automatically do so in every instance. The reason is that the materiality standards in the two regulations differ slightly. Since none of the federal court decisions on point have taken a position to the contrary, the Court would likely have upheld the Second Circuit's decision in *Liedos* on those same grounds.

This argument carries broader implications because it cuts against essentially all other extant readings of the issues raised by *Leidos*. In the academic scholarship, there is a uniform impression that *Leidos* will force the Court to confront an intractable disagreement over how much disclosure firms are required to provide to investors under federal law. Moreover, the relevant judicial opinions have often expressed the same conclusion, despite their underlying substantive agreement. Because the thesis of this article is that such an interpretation is radically incorrect, what is really at stake when considering the issues presented by *Leidos* is

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"circular"); Monsma & Olson, *supra* note 307, at 167 (same).

347. *See supra* Part III (discussing whether and when an Item 303 violation can constitute a Section 10(b) violation and ultimately concluding that it can but that a violation of Section 10(b) is not inevitable just because of the presence of an Item 303 violation).

a proper understanding of how the securities regulation regime operates at a fundamental, systemic level.

The Article's larger contribution therefore consists of identifying the two sources of confusion that have led the courts and academic literature astray in this area. First, the disclosure obligations imposed under Reg. S-K must be analyzed by approaching the twin pillars of the securities law framework, the 33 Securities Act and 34 Exchange Act, from an integrated perspective that identifies the common elements across those statutes. Although the anti-fraud prohibition under Rule 10b-5 has a number of unique features, the tendency to view Section 10(b) of the 34 Exchange Act in isolation from related provisions in the 33 Securities Act often leads to logically inconsistent interpretations of both statutes. Second, the central role granted to the "duty to disclose" in securities law is misplaced, because the application of that doctrine in cases involving nondisclosure claims simply begs the question. As a result, theoretical disputes over the precise meaning of the duty to disclose distract from the real legal issues presented, more often than not, and are best left unopened. The overarching claim of this Article is that, once these two misunderstandings are remedied, a more coherent picture of how federal securities regulation works will follow.