# “HALF-TRUTHS” and “PURE OMISSIONS”

## S-K Item 303 and Rule 10b-5

*The Supreme Court Spoke – Questions Remain*

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BRACEWELL

On April 12, 2024 the U.S. Supreme Court issued a unanimous decision in *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, 601 U.S. 257 (2024), holding that "pure omissions" cannot be the basis of an action under Rule 10b-5(b) promulgated by the Securities and Exchange Commission (the "SEC") under Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act").[1] Unsurprisingly, the Court held simply that Rule 10b-5(b) means exactly what it says – that omissions are unlawful, under clause (b) of the Rule, only if they are "necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." Rule 10b-5(b). Why would guidance from the highest court in the land be required to interpret this seemingly unambiguous language? A brief history of the litigation is necessary for a complete understanding of what the Supreme Court held and what it did not address, as well as related issues addressed in the lower courts.

**Background**

*District Court*

The City of Riviera Beach General Employees Retirement System in April 2018 brought a class action lawsuit in the U.S. District Court for the Southern District of New York ("District Court") asserting various securities law claims against Macquarie Infrastructure Corp. ("Macquarie" or "MIC"). *City of Riviera Beach General Emps. Ret. Sys. v. Maquarie Infrastructure Corp.*, No. 18-CV-3608, 2021 WL 4084572 (S.D.N.Y. Sept. 7, 2021). This suit was subsequently consolidated with a similar suit brought by Moab Partners, L.P. ("Moab"), with Moab being appointed Lead Plaintiff. The plaintiffs alleged, among other things, that Macquarie had made various misrepresentations and omissions of material facts in reports filed with the SEC under the 1934 Act and elsewhere regarding its business and prospects, including, particularly, the anticipated effect of a new governmental regulation that was likely to, and, in fact, did, have a material adverse impact on Macquarie's fuel storage business. The plaintiffs claimed, among other things, that disclosure of the uncertainties and expected trends resulting from the new regulation was required by Item 303 of Regulation S-K, "Management Discussion and Analysis of Financial Condition and Results of Operations" ("MD&A"), and that the omission of this information violated Item 303 and Section 10(b) of the 1934 Act and Rule 10b-5 thereunder (without specification of any particular subsection of the Rule). The plaintiffs also alleged that the omission violated Sections 11(a) and 12(a)(2) of the Securities Act of 1933 (the "1933 Act"), but this note will focus only on alleged violations of the 1934 Act since it was these allegations that laid the path to the Supreme Court.

Macquarie moved to dismiss generally on the grounds that the complaint did not adequately state a claim for securities fraud under Section 10(b) and Rule 10b-5. After noting the pleading requirements under case law and Rule 9(b) of the Federal Rules of Civil Procedure ("Rule 9(b)"), Macquarie recited the heightened pleading requirements of the Private Securities Litigation Reform Act of 1995 (the "PSLRA", now set forth in Section 21D of the 1934 Act), which provides in relevant part:

> In any private action arising under this title in which the plaintiff alleges that the defendant:
>
> (A) made an untrue statement of a material fact; or
>
> (B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;
>
> the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading…

Macquarie asserted that the plaintiff had "failed adequately to allege any actionable omission or misstatement [in the complaint], warranting dismissal", because, among other things:

- each of the allegedly omitted facts was either actually disclosed or otherwise "known to the market" and therefore not material as a matter of law[2]; and

- "… a failure to make a required Item 303 disclosure [is] actionable only if it satisfies the materiality requirements outlined in *Basic*, and if all the other requirements to sustain an action under Section 10(b) are fulfilled."[2]

On September 7, 2021, the District Court issued its Opinion & Order dismissing the consolidated complaint. (Docket Nos. 18-CV-3608(VSB) and 18-CV-3744). The District Court first noted the heightened pleading standards for securities fraud cases under Rule 9(b) and the PSLRA. The court then briefly noted the three different subsections of Rule 10b-5, with subsection (b) targeting misleading disclosures and subsections (a) and (c) targeting deceptive conduct without requiring a specific oral or written statement. Presumably, the court took note of the fact that the complaint simply alleged violations of Rule 10b-5, without specifying any particular subsection of the Rule.

The District Court then noted that there are two relevant situations in which a "duty to disclose" is imposed for purposes of Section 10(b):

- in the first such situation, the duty to disclose certain information arises when an affirmative statement is made that is literally true but it "creates a materially misleading impression" due to the omission of such information – i.e. when the affirmative statement made is only a "half-truth"; and

- in the second such situation, the duty to disclose certain information is imposed by a statute or regulation, such as Item 303 of Regulation S-K, citing *Stratte-McClure v. Morgan Stanley Corp.*[3]

The District Court then explained in detail why, in its view, the plaintiffs had failed to plead with sufficient specificity, under Rule 9 and the PSLRA, that alleged omissions were either "half-truths" or were required disclosures under Item 303 that were both known to the defendants and material. (Similarly, the court also found that the plaintiffs had not adequately pleaded "scienter".) The District Court ultimately dismissed the consolidated complaint, finding, among other things, that:

- while the plaintiffs alleged "a host of allegedly actionable misstatements and omissions", they did not identify any specific statements that were actionable as half-truths. In response to plaintiffs' claim that companies should "be forthright about the present facts, risks, and threats facing [their company] when affirmatively disclosing its business and environment (MTD Opp 29)", the District Court held, among other things, that "simply speaking on one's business does not trigger a duty to disclose all facts an investor may want to know no matter how tangential they are to what the speaker is talking about. Rather, the cases cited by Plaintiff show that the duty to be forthright is triggered when a defendant speaks with sufficient 'specificity' while omitting information that one would normally expect the defendant to have included had the defendant known it" (citing *Diehl v. Omega Protein Corp.*, 339 F.Supp.3d 153, 163 (S.D.N.Y. 2018)).

- the plaintiffs, while having alleged a violation of disclosure obligations under Item 303, did not "actually plead an uncertainty that should have been disclosed", in what SEC filings it should have been disclosed, that any omitted information was material or that defendants actually knew of an uncertainty requiring disclosure under Item 303.

Thus, the decision of the District Court seems to have been based primarily on a failure to fulfill the heightened pleading requirements of the PSLRA rather than on substantive law.

*Second Circuit*

The plaintiffs appealed the dismissal by the District Court to the U.S. Court of Appeals for the Second Circuit (the "Second Circuit"), largely on the grounds that the complaint did adequately allege that Macquarie's SEC reports omitted a material uncertainty that should have been disclosed under Item 303 (and also Item 503) and that the omitted information was required to make these reports not misleading. On December 20, 2022, the Second Circuit issued a Summary Order (No. 21-2524) (the "Summary Order") reversing the District Court and remanding for further proceedings. *Moab Partners, L.P. v. Macquarie Infrastructure Corp.*, No. 21-2524, 2022 WL 17815767 (2d Cir. Dec. 20, 2022). The court first noted that "a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact" (quoting *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993)). The court then pointed out the same two circumstances that require disclosure as the District Court – when necessary to avoid a "half-truth" (citing *Meyer v. JinkoSolar Holdings Co.,* 761 F. 3d 245, 250 (2d Cir. 2014)) and when specifically required by a statute or regulation (citing *Stratte-McClure*).

The Second Circuit concluded that the plaintiffs had adequately pleaded two separate causes of action:

- the District Court erred in determining that plaintiff failed to plead any 'half-truths'. "Having chosen to speak about their base of customers, Defendants had a duty to speak accurately, giving all material facts in addressing those issues to permit investors to evaluate the potential risks. *Setzer v. Omega Healthcare* [*Invs.*]*, Inc.*, 968 F.3d 204, 214 n.15 (2d Cir. 2020) (holding that the company need not 'disclose all the facts that pertain to a subject (many of which would be immaterial)), but instead [must] not … omit material facts whose omission, *in the light of what was stated*, would be misleading." (emphasis added) (Summary Order at 3)[4]. Since the court did not point to any specific statements made by Macquarie that were rendered misleading by omission, it appears that the court was referring to the discussion in MD&A of the customer base and related issues, taken as a whole.

- "Plaintiff has adequately alleged a 'known trend or uncertainty' that gave rise to a duty to disclose under Item 303" (citing *Stratte-McClure*, 776 F.3d at 101). [A] duty to disclose may arise when there is a statute or regulation requiring disclosure (quotations and citations omitted), such as Items 303 and 503 of SEC Regulation S-K. … The failure to make a material disclosure required by Item 303 can serve as the basis for claims under Sections 11 and 12(a)(2), and for a claim under Section 10(b) if the other elements have been sufficiently pleaded" (citing *Stratte-Mclure*, 776 F.3d at 101-04). (Summary Order at 3). As in *Stratte-McClure*, the court did not specify what part of Rule 10b-5 was applicable.

**Macquarie's Petition for Certiorari**

Macquarie petitioned the U.S. Supreme Court in Docket No. 22-1165 (the "Petition") for a writ of certiorari on the single question of "whether a Section 10(b) claim can also rest on a failure to provide a disclosure required under Item 303 of SEC Regulation S-K, even without an affirmative statement that is rendered misleading by omission." (Macquarie Petition at 2). Macquarie alleged a split among the positions of the Second Circuit, on the one hand, and those of the U.S. Courts of Appeals for the Third, Fifth, Ninth, and Eleventh Circuits, on the other, on whether an alleged violation of the duty to disclose under Item 303 can support a private cause of action under Section 10(b) and Rule 10b-5. (Macquarie Petition at 2-4). Interestingly, while Rule 10b-5 is referred to throughout the Petition, the Petition does not specify any particular subsection of the Rule. A discussion of the complex and sometimes confusing alleged conflict among the circuits is beyond the scope of this note.

Moab filed a brief in opposition to Macquarie's petition for certiorari arguing that the Second Circuit's decision was correct and that certiorari was not necessary. (Moab Brief at 26). Moab stated that the decision tracked the text of Section 10(b), which prohibits "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe," and then recited all three clauses of Rule 10b-5. Then Moab argued, pointedly,

> As the text makes clear, §10(b) broadly prohibits the use of 'any … deceptive device or contrivance. (citation omitted) This can include SEC-mandated filings that deliberately or recklessly omit required, material information because investors can be led to believe that the omitted facts do not exist or that the stated facts provide a truthful depiction of the company's prospects, when in fact they do not. (Moab Brief at 26-27)

Macquarie filed a Reply Brief in which it clarified somewhat the alleged split among the circuits, pointing out that there is no such split with respect to "half-truths". In all circuits an omission necessary to make statements affirmatively made not misleading – i.e., the essence of subsection (b) of Rule 10b-5 – is actionable, whether or not the omitted information is specifically required by Item 303. The split exists with respect to "pure omissions", which are actionable only in the Second Circuit, explaining:

> Moab ignores the statutory distinction between a pure omission and a half-truth—that is, a situation where a duty to disclose arises because the speaker's affirmative statements would otherwise be misleading. The cases Moab cites all involve the latter. (citations omitted)
>
> Moab thus overlooks the actual issue on which the circuits are split—whether Item 303 supplies a duty to disclose that, if breached by silence, can provide an independent basis for a private right of action under Section 10(b) in the absence of any affirmative statement rendered misleading by omission. (Macquarie Reply Brief at 3)

Several *amici* filed briefs in support of the decision of the Second Circuit, including the United States through the Department of Justice and the SEC which supported the decision of the Second Circuit as to both the "half-truth" analysis and also the "pure omission" analysis.

As to "half-truths", the U.S. relied on Rule 10b-5(b) and argued that, since Macquarie had made statements in MD&A disclosing certain trends and uncertainties or MD&A, Macquarie implicitly

represented that those were all the trends and uncertainties that were required to be disclosed. The existence of undisclosed information made these "statements" in MD&A misleading:

> [F]urther disclosure was "necessary" to make these statements "not misleading" "in light of the circumstances", 17 C.F.R. 240.10b-5(b), because a reasonable investor would understand … that all the information required by Item 303 was being disclosed. (U.S. Amicus Brief at 10)

The U.S. noted Macquarie's argument that there must be some "link" between the omitted fact and the affirmative statement that is allegedly rendered misleading by the omission – a link such as common subject matter. The U.S. agreed that, in the absence of a specific disclosure requirement, some degree of linkage may be necessary to make the omission and the affirmative statement sufficiently "like in kind" for the statement to be considered a misleading half-truth. On the other hand, where a statute or regulation, like Item 303, specifically "defines the class of information that must be disclosed, a statement issued in purported compliance with the requirement necessarily implies the absence of additional information within the class. Because Item 303 requires an issuer to disclose all known trends or uncertainties that satisfy a specified regulatory standard, the identification of some such trends or uncertainties but not others itself makes the MD&A's narrative 'misleading' 'in light of the circumstances.' 17 C.F.R. 240.10b-5(b)." (U.S. Amicus Brief at 17)

As to "pure omissions", the U.S. noted that, where there is an independent duty to disclose an item of information, its omission may be actionable under Section 10(b) as a "manipulative or deceptive device or contrivance in contravention of SEC rules," and, further, under subsection (a) and/or (c) of Rule 10b-5. (U.S. Amicus Brief at 19-21)

Thus, the U.S. in effect argued that the omission of information required under Item 303 (or, presumably, any other statute or regulation) is actionable under Rule 10b-5 either:

- because the disclosure document (or a section thereof) is itself a "half-truth", inasmuch as it paints an incomplete and misleading picture, and is actionable under Rule 10b-5(b), consistent with *Stratte-McClure*, or

- because the "pure omission" of the required information is actionable under Rule 10b-5 (a) or (c).

As to the U.S.'s Rule 10b-5(b) argument, "half-truths" and "pure omissions" appear to be somewhat conflated since the statement rendered misleading by omission is not a specific statement but an entire document (or section thereof) that reflects the "pure omission" of the required information.

**Holding of the Supreme Court**

The U.S. Supreme Court took note of the apparent disagreement among the courts of appeals on the specific question of "whether a failure to make a disclosure required by Item 303 can support a private claim under §10(b) and Rule 10b-5(b) in the absence of an otherwise-misleading statement", and the Court granted certiorari to resolve that particular disagreement. (*Macquarie Infrastructure Corp.*, 601 U.S. at 263)

The Court first quoted Rule 10b-5(b), and, for emphasis, it bears quoting again in this note:

> Rule 10b-5(b) makes it unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." (emphasis added)

Thus, Rule 10b-5(b) prohibits "half-truths". It does not prohibit pure omissions, as does 11(a) of the 1933 Act. Rather, Rule 10b-5(b) specifically requires that some "statements made" in the disclosure be rendered misleading by the omission in question. The Court confirmed that a "failure to disclose information required by Item 303 can support a claim under Rule 10b-5(b) only if the omission renders affirmative statements made misleading. … Pure omissions are not actionable under Rule 10b-5(b)." *Id.* at 258-60.

The Court took note of the arguments made by Moab and the United States to the effect that reasonable investors are aware of the requirements of Item 303 and that, accordingly, the absence of a disclosure is an implicit representation that the omitted fact does not exist. The Court's response was as follows:

> Moab and the United States suggest that a plaintiff does not need to plead any statements rendered misleading by a pure omission because reasonable investors know that Item 303 requires an MD&A to disclose all known trends and uncertainties. That argument fails, however, because it reads the words "statements made" out of Rule 10b-5(b) and shifts the focus of that Rule and §10(b) from fraud to disclosure. *See Chiarella v. United States*, 445 U.S. 222, 234-235 … (1980) ("Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud"). It would also render §11(a)'s pure omission clause superfluous by making every omission of a fact "required to be stated" a misleading half-truth.

*Id.* at 265. Thus, a plaintiff is indeed required to plead some "statement" or "statements" as having been rendered misleading by the omission, but the Court did not give further guidance.

The Court concluded its opinion with the following footnote:

> Moab and the United States spill much ink fighting the question presented, insisting that this case is about half-truths rather than pure omissions. The Court granted certiorari to address the Second Circuit's pure omission analysis, not its half-truth analysis. See Pet. for Cert. i ("Whether … a failure to make a disclosure required under Item 303 can support a private claim under Section 10(b), *even in the absence of otherwise-misleading statement*" (emphasis added); see also 2022 WL 17815767, *1 (Dec. 20, 2022) (distinguishing between these "two circumstances"). The Court does not opine on issues that are either tangential to the question presented or were not passed upon below, including what constitutes "statements made," when a statement is misleading as a half-truth, or whether Rules 10b-5(a) and 10b-5(c) support liability for pure omissions.

*Id* at 266 n.2.

The Court clearly limited its holding to the specific question on which it granted certiorari, leaving open various questions including those listed in its powerful footnote. It is unambiguous that a plaintiff must specify some "statement" that is rendered misleading by an omission, which seems to be the position of the District Court in this litigation. However,

- must this "statement" be a single sentence?
- may this "statement" consist of several statements taken together?
- may this "statement" be an entire paragraph or section of a disclosure document taken as a whole?

It would appear unwise, even in the Second Circuit, for a plaintiff to allege merely that an entire MD&A is misleading by virtue of an omission, based on the theory espoused by the United States in its amicus brief – that is, the theory that no "linkage" between the omitted information and some affirmative "statement made" is necessary where the omitted information was specifically required by statute or regulation. (U.S. Amicus Brief at 16-17). Rather, it would behoove a plaintiff to plead with some degree of specificity that some identified "statement" or "statements" were rendered misleading by omission. The degree of specificity required may vary among the different circuits and will certainly vary with the factual landscape. An allegation that an MD&A presentation, taken as a whole and absent the omitted information, constitutes a "statement" that paints a misleading picture of the company is likely not sufficient, even if true, without at least some specificity in the pleadings. Such an allegation likely would be viewed as an attempt to convert a "pure omission" into a "half-truth", which was seemingly rejected by the Supreme Court.

Of course, the need for specificity also would appear to be consistent with the requirements of the PSLRA which must be satisfied in any event. This raises the question of whether all the appellate proceedings in this litigation might have been avoided if the consolidated complaint had been more fully responsive to the requirements of the PSLRA.

The Supreme Court also left open the question of whether and to what extent a "pure omission" may be actionable under Rule 10b-5(a) and/or Rule 10b-5(c) as a "manipulative or deceptive device or contrivance" under Section 10(b) of the 1934 Act. The United States, in its amicus brief cited numerous cases in which simple failures to disclose required information resulted in liability under subsection (a) and/or (c) of the Rule (the "scheme subsections"). A plaintiff alleging that a misstatement or omission resulted in a violation of one or both of the scheme subsections would also have to show the alleged omission was a "device, scheme, or artifice to defraud…", as required by subsection (a), or an "act, practice, or course of business which operates…as a fraud or deceit…", as required by subsection (c).[5] Finally, while no case has been found that suggests that the factors required to demonstrate "scienter" vary among the different subsections of the Rule, a related question is whether liability under the scheme subsections necessarily requires a higher level of intent in order to prove "scienter" than liability under subsection (b). Thorough discussion of "scienter" is beyond the scope of this note. However, the authorities listed in Endnote 6 provide some basic insights.

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## ENDNOTES

[1] Section 10 of the 1934 Act provides in relevant part:

> 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:
>
> (a) To 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 or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5 under Section 10(b) of the 1934 Act provides:

> 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:
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact *necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading* (emphasis added), or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

In contrast to Rule 10b-5(b), as well as Section 12(a)(2) of the 1933 Act, Section 11(a) of the 1933 Act imposes liability for the omission from a registration statement of a material fact *required to be stated therein*, as well as for statements made that are rendered misleading by omission.

[2] Macquarie's Memorandum of Law in Support of its Motion to Dismiss (document 101 in docket of District Court), citing *Lipow v. Net1 UEPS Techs., Inc.*, 131 F. Supp. 3d 144, 168-69 (S.D.N.Y. 2015); *Monroe Cty. Emps.' Ret. Sys v. YPF Socieded Anonima*, 15 F. Supp. 3d 336, 349 (S.D.N.Y. 2014), which, in turn cited *In re: WorldCom, Inc. Sec. Litig.*, 346 F. Supp 2d 628, 687-88 (S.D.N.Y. 2004) ("*WorldCom*") and *United Paperworkers Int'l Union v. Int'l Paper Co.*, 985 F.2d 1190 (2d Cir. 1993).

Macquarie argued that the facts allegedly omitted were "widely known in the market" and therefore not material as a matter of law. Macquarie cited the second part of the definition of "material" as established in *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976) and adopted generally in *Basic v. Levinson*, 485 U.S. 224, 231-232 (1988), which is that for an omitted fact to be considered material there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.

"Obviously, further disclosure of facts that are already in the public domain cannot 'alter the total mix of information' available to the investor." (Document 101 at 15-16)

It must be noted that the notion of widely known information not being considered material is likely not applicable in the context of Section 11 or Section 12(a)(2) of the 1933 Act or Section 14(a) or Rule 14a-9 under the 1934 Act. See *Worldcom* at 688, citing *Kronfeld v. Trans World Airlines, Inc.*, 832 F.2d 726, 736 (2d Cir. 1987). See also Endnote 5 in Section 11 in Review – A Reminder to Directors and Officers, by J. Anthony Terrell (2023).

For a detailed discussion of materiality, see "Materiality in Review – Probability, Magnitude and the Reasonable Investor", by J. Anthony Terrell (2021).

[3] *Stratte-McClure v. Morgan Stanley Corp.*, 776 F.3d 94, 101 (2d Cir. 2015*) ("Stratte-McClure"*). Interestingly, and perhaps curiously, *Stratte-McClure* is cited by the District Court only in its discussion of "pure omissions" – that is, in its discussion of the omission of information required by statute or regulation – and not in its discussion of "half-truths. However, a careful reading of *Stratte-McClure* suggests that it is, at least to some extent, based on the "half-truth" theory:

> A plaintiff must then allege that the omitted information was material under Basic's probability/magnitude test, because 10b-5 only makes unlawful an omission of "material information" that is "necessary to make … statements made," *in this case the Form 10-Qs*, "not misleading". (emphasis added)

This language suggests that the Second Circuit, in *Stratte-McClure,* is looking at the entire Form 10-Q as the relevant "statements made". To that extent, *Stratte-McClure* is arguably a "half-truth" case as well as a "pure omission" case – the line becomes blurred.

Following the excerpt quoted above, the Second Circuit in *Stratte-McClure* went on to emphasize that, in addition to materiality, all the other elements of a 10b-5 claim must be pleaded. *See Stratte-McClure* at 103.

[4] The Second Circuit went on to state that "[t]he omissions are not cured by disclosures that MIC did make – including those regarding 'changes in government regulations' and 'capital expenditures' related to repurposing tanks – which did not reveal the information necessary for the investing public to make a proper assessment of the alleged risks. *See JinkoSolar Holdings Co.*, 761 F. 3d at 251 ('A generic warning of a risk will not suffice when undisclosed facts on the ground would substantially affect a reasonable investor's calculations of probability.') Accordingly, the generic cautionary language here does not satisfy Defendants' disclosure obligations". (Summary Order at 4)

[5] While a misstatement or omission could be a basis for liability under the scheme subsections of Rule 10b-5, it cannot be the sole basis for liability – some other act or circumstance is needed. *See Securities and Exchange Commission v. Rio Tinto PLC*, 41 F.4th 47 (2d Cir. 2022), citing *Lorenzo v. Securities and Exchange Commission*, 587 U.S. 71 (2019) which held, in substance, that "dissemination" of information known to be false or misleading was a violation of the scheme subsections. A related issue is that only the "maker" of the misleading statement – that is, "the person or entity with ultimate authority over the statement, including its content and how to communicate it" – can have liability under Rule 10b-5(b). *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011). However, a person or entity that is not the "maker" (which could include an employee or agent of the issuer)

can still have liability under the scheme subsections under *Lorenzo* and *Rio Tinto*, assuming some such additional act or circumstance.

[6] The seminal case on "scienter" is *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), in which the Supreme Court required proof of "scienter" in a civil action under Section 10(b) and Rule 10b-5, defining "scienter" as "intent to deceive, manipulate or defraud" and "a mental state embracing intent to deceive, manipulate or defraud". Id. at 193, n. 12. The Court clearly ruled out simple negligence as a basis for liability. While the Court noted that lower courts had found that forms of reckless conduct could be the basis of liability, the Court did not define recklessness or address whether or not recklessness can constitute "scienter", for purposes of Section 10(b) or Rule 10b-5. See Jeanne P. Bolger, *Recklessness and the Rule 10b-5 Scienter Standard after Hochfelder*, 49 Fordham L. Rev. 817 (1981). In *Moab v. Macquarie*, the Second Circuit found that "the Complaint adequately alleges that Defendants acted with scienter in making the material omissions or false or misleading statements". In particular, the court succinctly stated the existing law in the Second Circuit on page 4 of its Summary Order:

> The scienter requirement may be satisfied "either (a) by alleging facts to show that the defendants had *both motive and opportunity to commit fraud*, or (b) by alleging facts that constitute strong circumstantial evidence of *conscious misbehavior or recklessness* (citing *Ganino v. Citizens Utilities Co.*, 228 F. 3d 162 (2d Cir. 2000) (emphasis added).

See also *Holtzman v. Omega Healthcare Investors, Inc.*, No. 19-1095 (2d Cir. 2020) and the cases cited therein for a full discussion of "conscious recklessness – i.e. a state of mind approximating actual intent, and not merely a heightened form of negligence", *Id*. at 17 (citing *Stratte-McClure*, 776 F. 3d at 106), and, in particular, a suggestion that the analysis required to show "motive and opportunity" is different from, and perhaps more rigorous than, that required to show "conscious recklessness". Id at 17, n.11. Query whether, in an action alleging a violation of subsection (a) or (c) of Rule 10b-5, the "scheme subsections", "conscious recklessness" should apply as standard to determine the existence of scienter. Perhaps the plaintiff should be required to show either "conscious misbehavior" or "both motive and opportunity to commit fraud", which, in either case, might call for a higher level of intent than "conscious recklessness".

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This note was prepared by J. Anthony Terrell as of July 1, 2024. Mr. Terrell is Of Counsel to Bracewell LLP, resident in the New York office. However, the views expressed herein are those of Mr. Terrell only and do not necessarily reflect the views of the firm. Mr. Terrell is a member of the American Bar Association, the New York City Bar Association and the International Bar Association and various sections and committees of each. This note does not necessarily reflect the positions of any of such bar associations, sections, or committees.



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