No. 16-581

IN THE
Supreme Court of the United States

LEIDOS, INC.,
Petitioner,
v.

INDIANA PUBLIC RETIREMENT SYSTEM,
INDIANA STATE TEACHERS' RETIREMENT FUND,
AND INDIANA PUBLIC EMPLOYEES' RETIREMENT FUND,
Respondents.

**On Writ of Certiorari
to the United States Court of Appeals
for the Second Circuit**

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QUESTION PRESENTED

Whether an issuer of publicly traded securities that deceptively omits from a securities filing material information required to be disclosed under Item 303 of SEC Regulation S-K violates § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

RULE 29.6 STATEMENT

None of the respondents is a non-governmental corporation for which a disclosure statement pursuant to this Court's Rule 29.6 is required.

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INTRODUCTION

For nearly four decades, the Securities and Exchange Commission has required a publicly traded company to disclose to investors management's analysis of important developments facing the company. That narrative analysis (required by a regulation referred to as Item 303) can be especially important to investors in interpreting a company's financial results and business prospects. When companies have violated that disclosure rule in a deceptive way, the Commission and private investors have sought appropriate remedies under § 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

Petitioner seeks a blanket rule that omitting information the disclosure of which is required by Item 303 is *never* the type of deceptive conduct that § 10(b) and Rule 10b-5 prohibit. That sweeping rule is unsupported by the statutory and regulatory text, or by this Court's cases concerning omissions in similar contexts. Petitioner's theory also contains no limiting principle and would immunize companies from both government and private actions for deceptive violations of other SEC disclosure rules designed to protect the investing public.

The fraud alleged in this case demonstrates why petitioner's blanket immunity rule is so unsound. In a March 2011 annual report on SEC Form 10-K, petitioner deceived investors regarding the prospects of its government-contracting business. When it made that filing, petitioner had known for months (if not longer) about a massive kickback-and-overbilling scheme engulfing its $635 million CityTime contract to develop a timekeeping program for New York City. App. 6a, 19a-20a. By that time, the CityTime project was already the subject of multiple law-enforcement investigations, and the growing scandal posed a major

threat to petitioner's business prospects. App. 6a, 19a-20a. In fact, petitioner had already lost business opportunities worth more than $150 million because of the CityTime investigations. App. 19a. Petitioner also knew that the negative publicity accompanying the eventual public disclosure of its central role in the CityTime scandal could harm its plans to market the CityTime software to other government agencies — a market opportunity that petitioner valued at approximately $2 billion, 20% of its yearly revenue. App. 20a-21a. Despite those facts, petitioner's March 2011 annual report contained no disclosure regarding CityTime.

Petitioner's March 2011 report did, however, contain certifications signed by petitioner's chief executive officer and its chief financial officer attesting that the report "fully complies" with federal securities laws. JA1121-22. But the report did not comply with those requirements. Even though Item 303 required petitioner to disclose known material "uncertainties" likely to affect its business prospects, 17 C.F.R. § 229.303, and even though the report gave every indication that it contained all of the information required to be disclosed therein, petitioner did not reveal that, by March 2011, the problems with CityTime were having and likely would continue to have a major negative impact on its business. Ultimately, a year later, petitioner entered into a deferred prosecution agreement with federal and state authorities that required it to pay more than $500 million in restitution and penalties, and petitioner admitted to defrauding the City. App. 8a.

In allowing this case to proceed past the pleading stage, the Second Circuit properly held that such omissions can support federal securities fraud claims in appropriate cases. That judgment should be affirmed.

STATEMENT OF THE CASE

A. Statutory And Regulatory Background

"After rampant abuses in the securities industry led to the 1929 stock market crash and the Great Depression," *Kokesh v. SEC*, 137 S. Ct. 1635, 1639-40 (2017), Congress enacted a series of reforms, including the Securities Act of 1933 and the Securities Exchange Act of 1934. The 1933 Act regulates initial offerings of securities, and the 1934 Act regulates secondary trading. *See Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 135 S. Ct. 1318, 1323 (2015); *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 171 (1994). The 1934 Act also created the Commission and gave it broad authority to regulate the securities industry. *See Kokesh*, 137 S. Ct. at 1640; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976); 15 U.S.C. §§ 78d, 78m, 78w.

Congress's purpose in enacting those statutes was to "promote investor confidence" in the securities markets, *SEC v. Zandford*, 535 U.S. 813, 819 (2002), by "'substituting a philosophy of full disclosure for the philosophy of *caveat emptor*,'" *Kokesh*, 137 S. Ct. at 1639-40 & n.1 (quoting *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963)) (brackets omitted). Congress recognized that "the hiding and secreting of important information obstructs the operation of the markets as indices of real value." *Basic Inc. v. Levinson*, 485 U.S. 224, 246 (1988).

Section 13 of the 1934 Act authorizes the Commission to establish requirements for periodic reporting of information by companies with publicly traded securities. It provides in pertinent part that securities issuers "shall file with the Commission . . . such

annual reports . . . as the Commission may prescribe." 15 U.S.C. § 78m(a)(2). The Commission has implemented § 13 with regulations providing that issuers "shall file" annual reports on forms prescribed by the Commission. 17 C.F.R. § 240.13a-1; *see id.* § 249.310(a) (Form 10-K "shall be used" for annual reports under § 13).

The Commission's Regulation S-K prescribes "the content of the non-financial statement portions" of "annual or other reports under section[] 13." *Id.* § 229.10(a)(2). Item 303 of that regulation requires annual reports to include management's discussion and analysis of the issuer's financial condition and results of operations — referred to as the "MD&A." *See id.* § 229.303. The portion of the MD&A relating to the results of operations must "[d]escribe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations." *Id.* § 229.303(a)(3)(ii). That provision creates a "disclosure duty" when "a trend, demand, commitment, event or uncertainty is both presently known to management and reasonably likely to have material effects on the registrant's financial condition or results of operation." Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, 54 Fed. Reg. 22,427, 22,429 (May 24, 1989).

The origins of the MD&A requirement "date to 1968," and the current framework was adopted in 1980. *Id.* at 22,427. The Commission has elaborated over time on the MD&A's purpose and importance in promoting meaningful disclosures to investors. *See id.* "The Commission has long recognized the need

for a narrative explanation of the financial statements, because a numerical presentation and brief accompanying footnotes alone may be insufficient for an investor to judge the quality of earnings and the likelihood that past performance is indicative of future performance." Concept Release on Management's Discussion and Analysis of Financial Condition and Operations, 52 Fed. Reg. 13,715, 13,717 (Apr. 24, 1987).

The 1934 Act also contains a broad prohibition on deceptive conduct. Section 10(b) of the 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 . . . [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 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.

15 U.S.C. § 78j(b) (footnote omitted).

Pursuant to § 10(b), the SEC promulgated Rule 10b-5. That rule makes it unlawful for a person to do any of the following in connection with the purchase or sale of any security in interstate commerce:

> (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, 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.

17 C.F.R. § 240.10b-5.

A person violates those provisions only when acting with scienter. *See Aaron v. SEC*, 446 U.S. 680, 687-95 (1980) (SEC enforcement action); *Hochfelder*, 425 U.S. at 196-214 (private action). Scienter in the § 10(b) context means "a mental state embracing intent to deceive, manipulate, or defraud." *Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 48 (2011); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007) (defining standard for pleading scienter in a private action). In addition, the omitted information must have been material, meaning there is "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." *Basic*, 485 U.S. at 231-32; *see Matrixx*, 563 U.S. at 38.

This Court "has found a right of action implied in the words of [§ 10(b)] and its implementing regulation." *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 157 (2008). Congress "ratified the implied right of action" when it enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA"). *Id.* at 165. "Congress, the Executive Branch, and this Court, moreover, have recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions." *Amgen Inc. v. Connecticut Ret. Plans & Tr. Funds*, 568 U.S. 455, 478 (2013). Private securities actions

are also "an indispensable tool with which defrauded investors can recover their losses — a matter crucial to the integrity of domestic capital markets." *Tellabs*, 551 U.S. at 320 n.4.

In addition to proving a violation of § 10(b) and Rule 10b-5 as described above, the elements of "a typical § 10(b) private action" (*Stoneridge*, 552 U.S. at 157) include: reliance, *see Basic*, 485 U.S. at 243, 248-49; *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 153-54 (1972); economic loss, *see Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341-42 (2005); and loss causation, *see id.* This case concerns "the scope of conduct prohibited by" § 10(b) and Rule 10b-5, not the additional "elements of the 10b-5 private liability scheme." *Central Bank*, 511 U.S. at 172.

B. Factual Background

Petitioner is a government contractor that provides technology services. PSAC[1] ¶ 26 (JA62). Petitioner relies almost exclusively on revenues from government contracts: in 2011, 97% of its revenues came from government agencies. *Id.* (JA63); JA829. As a government contractor, petitioner's compliance with pertinent federal, state, and local regulations is essential to its business. PSAC ¶¶ 72-97 (JA88-97). Employee or subcontractor fraud or misconduct can result in lost business opportunities, cancelled contracts, suspension, or debarment. *Id.*; JA847-48.

In 2000, New York City hired petitioner to design and implement CityTime, a timekeeping software

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[1] [Proposed] Second Am. Class Action Compl. for Violations of the Federal Securities Laws ("PSAC") (JA39-331). The Court accepts as true the facts alleged in the complaint. *See Tellabs*, 551 U.S. at 322.

program for City employees. PSAC ¶¶ 98-99 (JA97-98). The CityTime contract was an enormously valuable opportunity for petitioner. In a 2006 SEC filing, petitioner identified it as one of the 10 largest contracts of its type. *Id.* ¶ 105 (JA99). Petitioner saw CityTime as a stepping stone to other contracts in New York, *id.* ¶ 112 (JA101-02), and a $2 billion opportunity to develop a product that could be sold to other government clients, *id.* ¶¶ 106-115 (JA99-102). Petitioner's senior executives were involved in monitoring the contract. *Id.* ¶¶ 116-139 (JA103-10).

In 2002, petitioner hired Gerard Denault as Deputy Program Manager in charge of the CityTime project. *Id.* ¶ 31 (JA65). In 2003, Denault retained (without competitive bid) Technodyne — a small, relatively unknown company, whose principals he knew — as a subcontractor to provide staffing services on the project. *Id.* ¶¶ 31, 163 (JA65-66, JA117-18). That "relationship soon gave rise to an elaborate kickback scheme in which Technodyne illegally paid Denault and Carl Bell ([petitioner]'s Chief Systems Engineer) for each hour a Technodyne consultant or subcontractor worked on CityTime." App. 5a; *see* PSAC ¶ 417 (JA222-23). "The scheme encouraged Denault and Bell to hire more Technodyne workers than the project required and to inflate billable hours and hourly rates." App. 5a.

As early as 2004, employees of petitioner expressed concerns internally regarding the CityTime project. PSAC ¶ 223 (JA137-38). They elevated their concerns within the company, *id.* ¶¶ 253-259, 263, 272-275, 535 (JA148-53, JA155-57, JA284-86), including by filing an internal ethics complaint reporting possible kickbacks, *id.* ¶¶ 229-239 (JA140-44). One employee recognized that this was a "very serious

thing" because it imperiled petitioner's government-contracting business. *Id.* ¶ 232 (JA140). Yet petitioner took no action. *Id.* ¶¶ 86, 236-240, 263, 276 (JA93, JA142-44, JA153, JA157).

Beginning in 2006, the City agreed to take financial responsibility for cost overruns on the CityTime project through a contract amendment that petitioner saw as so important that the CEO took the unusual step of reviewing and approving it, twice. *Id.* ¶¶ 140-155 (JA111-15). After the 2006 amendment, petitioner's bills to the City (which included subcontractor and consultant charges) ballooned. *Id.* ¶¶ 147-150, 156-157, 405 (JA113-14, JA115-16, JA215). Petitioner ultimately billed more than $600 million on a project initially budgeted at one-tenth of that cost. *Id.* ¶ 148 (JA113).

As CityTime costs exploded, authorities began to take notice. In 2008, the City conducted an audit showing that petitioner was submitting timesheets for consultants who had been terminated as many as 10 weeks before the date of the last timesheet. *Id.* ¶¶ 286-287 (JA162). In December 2010, federal and state officials announced the filing of criminal charges relating to the CityTime project, including charges against the principals of two subcontractors hired by Technodyne. *Id.* ¶¶ 139, 322 (JA110, JA174). Although the unsealed criminal complaint did not mention petitioner (or its project manager Denault) by name, the complaint provided strong evidence that the concerns petitioner's employees had been raising internally to management for years were, in fact, well-founded. *Id.* ¶¶ 322-339, 380 (JA174-85, JA202). Also, in December 2010, petitioner and Denault received federal grand jury subpoenas seeking records and testimony relating to the CityTime

project, and Denault was interviewed by criminal investigators. *Id.* ¶¶ 340-348 (JA186-89). Petitioner placed Denault on administrative leave and agreed to advance his legal fees relating to the investigation and resulting criminal proceeding. *Id.* ¶¶ 349, 363-366 (JA189, JA196-97). By December 19, 2010, petitioner had engaged outside counsel to conduct a confidential internal investigation of the CityTime matter. *Id.* ¶¶ 350-352 (JA190-91). The company's own internal investigative efforts had begun months earlier. *Id.* ¶ 352 n.5 (JA190).

Petitioner immediately felt repercussions from the December 2010 criminal complaint. The City promptly made clear that it intended to investigate petitioner's role with the goal of "recouping any funds" and "maximiz[ing] recovery of any taxpayer dollars that were improperly paid." *Id.* ¶¶ 370-371 (JA198-99). In addition, on December 21, 2010, New York State's Comptroller rejected petitioner's bid for a $118 million contract with the Metropolitan Transit Authority ("MTA"), citing "too many unanswered questions" regarding petitioner's "unclear" role in the CityTime fraud. *Id.* ¶¶ 355-361 (JA191-95). The next day, the City rejected another bid from petitioner for a contract valued at $40 million. *Id.* ¶ 362 (JA196).

In early 2011, nonpublic information known to petitioner regarding the pervasive fraud in the CityTime project continued to accumulate. In January 2011, Bell abruptly resigned on the same day that petitioner's counsel interviewed him about his involvement in CityTime. *Id.* ¶¶ 376-377 (JA201). In February, Bell received two grand jury subpoenas regarding potential criminal violations and was interviewed by criminal investigators. *Id.* ¶¶ 383, 390

(JA203, JA208). As it had done for Denault, petitioner agreed to advance Bell's legal fees. *Id.* ¶ 391 (JA208). On March 9, 2011, petitioner's internal audit team completed a review of Denault's timekeeping practices, the conclusions of which led petitioner in May to offer to refund all amounts billed for Denault's time and to terminate Denault. *Id.* ¶¶ 393-399 (JA209-12).

In the December 2010-March 2011 period, petitioner made no public statements to investors about the CityTime scandal. On March 25, 2011, petitioner filed its 2011 annual report on SEC Form 10-K. *Id.* ¶ 496 (JA263-64). The report included an MD&A section, as required by Item 303 of SEC Regulation S-K. JA898-942. Neither in the MD&A nor anywhere else in the report did petitioner disclose the CityTime scandal. The report also did not state that petitioner was refusing to provide any information required under the SEC's regulations. On the contrary, as required by the Sarbanes-Oxley Act of 2002, the report contained certifications by petitioner's CEO and its CFO that the report "fully complies with the requirements of Section 13(a) . . . of the [1934] Act." JA1121-22.

The MD&A in the March 2011 annual report referred investors to the report's "Risk Factors" section for information on "risk and uncertainties" relating to petitioner's federal government contracting business. JA903. In the "Risk Factors" section, the report discussed the company's heavy reliance on government contracts and warned that, if petitioner's "reputation or relationships with [government] agencies were harmed, [its] future revenues and growth prospects would be adversely affected." JA847. The report further explained that petitioner's reputation could

be harmed by "negative publicity regarding [its] work for state and local government and commercial customers" and "subcontractor misconduct." JA848, JA863-64. The report did not disclose, however, that subcontractor misconduct on a significant local government contract was *already* affecting its reputation and prospects.

Petitioner's MD&A also disclosed that petitioner was "subject to a number of reviews, investigations, claims, lawsuits and other uncertainties related to [its] business" and directed investors to review Notes 18 and 19 of its consolidated financial statements "[f]or a discussion of these items." JA928. But the lengthy, narrative discussion of several specific proceedings, and the general discussion of the risks presented by government investigations, omitted any mention of CityTime. JA1037-53.

Petitioner's silence as to CityTime continued until it filed a Form 8-K with the SEC on June 2, 2011, the same day that it held a conference call with analysts and investors to discuss its first-quarter 2011 financial results. App. 6a-8a. That public statement followed the unsealing of a criminal complaint against Denault on May 27, 2011. PSAC ¶¶ 403-407 (JA213-16). Only after Denault was criminally charged did petitioner acknowledge publicly the existence of "investigations relating to the CityTime contract." *Id.* ¶¶ 408-409, 503-508 (JA217, JA266-74). On June 29, 2011, the City formally requested reimbursement for approximately $600 million in CityTime revenues. *Id.* ¶ 511 (JA274-77). The request stated that the "scheme to defraud was so pervasive" that virtually all of the money petitioner had received was "tainted,

directly or indirectly, by fraud." *Id.* (JA276).[2] Between March 25, 2011, and June 2, 2011, respondents purchased petitioner's stock, unaware that their assessment of the company was based on less than the full truth known to petitioner.

A year later, in March 2012, federal and state officials jointly announced a deferred prosecution agreement with petitioner. *Id.* ¶¶ 413-422 (JA219-27). In what authorities described as the "Largest Known Single Recovery in a State or Municipal Contract Fraud Case," petitioner agreed to pay the "staggering sum" of nearly $500.4 million in restitution and penalties for its role in the CityTime fraud and to release a claim to $40 million in outstanding receivables. *Id.* ¶¶ 413, 415 (JA219-21). Petitioner reported significant losses in its net income and operating income in the last two quarters of 2012 — in contrast to the healthy profits it had reported in those quarters the previous year. *Id.* ¶¶ 442-448 (JA234-38). In addition to that "unprecedented financial recovery," petitioner agreed to take significant corrective actions, including retaining an independent monitor and implementing a permanent compliance program. *Id.* ¶¶ 413, 415 (JA220-21). Petitioner also agreed to a detailed statement of responsibility stating that it "accept[ed] responsibility for the illegal conduct alleged against Denault and admitted by Bell during the course of the CityTime project." *Id.* ¶¶ 415, 420 (JA222, JA224). Petitioner further admitted that, as a result of numerous "managerial failures," the "City was defrauded by [petitioner]." *Id.* ¶ 420 (JA224-25).

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[2] In October 2011, petitioner fired three executives who were responsible for supervising Denault and CityTime. PSAC ¶ 416 (JA222).

C. Procedural History

1. In 2012, respondents filed a complaint in the district court against petitioner alleging violations of the federal securities laws. After the district court appointed them as lead plaintiffs under the PSLRA, respondents filed an amended complaint. In the operative complaint reviewed by the Second Circuit, respondents alleged that petitioner's SEC filings omitted information about CityTime necessary to make the statements in those filings not misleading and that petitioner's failures to disclose information relating to CityTime were deceptive, in violation of § 10(b) and Rule 10b-5. PSAC ¶¶ 5, 455, 496, 499, 527, 564-565 (JA55, JA244-45, JA263-65, JA282, JA301-11).[3] As amended and modified by court order on remand from the Second Circuit's decision under review, the proposed plaintiff class now consists of investors who purchased petitioner's common stock between March 25, 2011, and June 2, 2011, and were damaged thereby.[4]

In the district court, petitioner moved to dismiss the amended complaint for failure to state a claim. As relevant here, petitioner argued that Item 303 of Regulation S-K did not require disclosure of the CityTime scandal because, according to petitioner, respondents had not alleged that petitioner's senior management knew of the CityTime fraud or that it would have a material effect on petitioner's financial condition.[5] Petitioner did not argue, as it does in

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[3] *Cf. Johnson v. City of Shelby*, 135 S. Ct. 346, 346 (2014) (per curiam) (federal rules do not require pleading "the legal theory supporting the claim asserted").

[4] *See* Second Am. Compl. ¶ 1, Dkt. #160 (Oct. 31, 2016).

[5] *See* Dkt. #72, at 16-17; Dkt. #85, at 13-15; Dkt. #105, at 7-8; Dkt. #110, at 6-7; Dkt. #131, at 16-18.

this Court, that the omission of information required under Item 303 can never support a § 10(b) claim.

The district court initially denied the motion to dismiss with respect to petitioner's failure to disclose the CityTime affair in the March 2011 annual report. App. 64a, 71a-72a, 73a-74a. The court subsequently granted petitioner's motion for reconsideration and dismissed respondents' claims in their entirety. App. 38a-50a. Respondents moved for relief from the judgment and sought leave to file the PSAC. The court denied the motion in full. App. 27a-37a.

2. The Second Circuit vacated the district court's judgment and the denial of leave to amend, and remanded for further proceedings. App. 1a-26a. As relevant here, the court of appeals held that the district court had erred in dismissing respondents' § 10(b) claim insofar as the claim was based on petitioner's failure to disclose the CityTime matter in the March 2011 annual report. App. 16a-23a.

The Second Circuit rejected the district court's conclusion that Item 303 of Regulation S-K did not require disclosure under the circumstances alleged in the complaint. App. 17a-21a. The court explained that the PSAC's allegations "support[ed] a strong inference that [petitioner] actually knew" before filing its March 2011 annual report: about the CityTime fraud, about the potential for substantial financial penalties, about the loss of pending contract awards worth more than $150 million, and that the scandal "jeopardized [petitioner]'s existing or future relationships with other governmental entities that accounted for a significant amount of its revenues." App. 19a-20a. Under those circumstances, the court held, Item 303 required disclosure. App. 20a.

The Second Circuit also rejected petitioner's argument that the CityTime matter was immaterial. App. 20a-21a. It explained that the scandal both jeopardized a $2 billion opportunity to market CityTime to new customers and threatened "significant civil and even criminal liability . . . and the resulting risk of . . . debarment from other government contracts altogether." App. 21a.

The court of appeals likewise held that scienter was adequately pleaded under the PSLRA. App. 21a-23a. It reasoned that the PSAC's allegations "strongly suggest that by March 9, 2011, when [petitioner] received the results of its internal investigation but before it filed its 10-K, [petitioner] knew about Denault's kickback scheme" and "the extent of the CityTime fraud." App. 21a-22a. The court rejected petitioner's argument that it was "implausible" that petitioner "would deliberately conceal" the matter "for just over two months, from the filing of the 10-K on March 25 until [petitioner]'s disclosures on June 2, 2011." App. 22a. The court explained that it was "cogent and at least as compelling" to infer that, at the time petitioner filed the annual report, it "believed it had more time before prosecutors would reveal its role in the scheme and before the City formally requested reimbursement," meaning that from petitioner's perspective "the benefits of concealment might have exceeded the costs as of March 2011." *Id.* (brackets omitted).

SUMMARY OF ARGUMENT

I.A. A public company that deceives investors by omitting required, material information from a publicly filed annual report violates § 10(b) of the 1934 Act and SEC Rule 10b-5. Section 10(b) broadly prohibits the use of "any . . . deceptive device or contrivance." Filing an annual report on Form 10-K that purports to comply with the disclosure requirements of the securities laws but in fact deliberately omits required, material information is "deceptive" because it leads reasonable investors to conclude that the omitted facts do not exist.

This Court's cases recognize that principle. In *Omnicare*, this Court analyzed whether an omission was misleading by looking to the expectations of a "reasonable investor." 135 S. Ct. at 1327. In *Universal Health Services, Inc. v. United States ex rel. Escobar*, 136 S. Ct. 1989 (2016), the Court explained that even a disclosure that is true "so far as it goes" is deceptive when it omits pertinent additional information. *Id.* at 2000. In this context, a reasonable investor expects formal SEC filings such as annual reports to contain the material information required to be disclosed therein. When a company withholds required, material information, investors can be deceived even if the affirmative statements in the filing are otherwise true so far as they go.

The deceptive omission of required, material information in an annual report implicates each of the three prongs of Rule 10b-5. When the report gives reasonable investors the false impression that they have received the material information required to be disclosed, the omission renders the statements in the report misleading, *see* 17 C.F.R. § 240.10b-5(b), as recognized in *Omnicare* and *Universal Health*.

Omissions under those circumstances also violate the prohibitions on employing "any device . . . to defraud" or "act . . . which operates . . . as a fraud or deceit." *Id.* § 240.10b-5(a), (c). "Deception through nondisclosure," *United States v. O'Hagan*, 521 U.S. 642, 654 (1997), violates those proscriptions.

B. Petitioner mischaracterizes the question in this case as whether a "pure omission" violates § 10(b). Whatever that phrase means, it cannot reasonably be used to describe the actions of a company that publicly files an annual report that purports to comply with the securities laws but in fact omits required, material information. The question in this case is not whether a public company has to issue a press release every time it learns of a problem affecting its business. Instead, the question is whether the 1934 Act's broad antifraud provision reaches deception committed through a misleading securities filing that purports to, but does not, comply with SEC disclosure obligations. That deceptive conduct misleads reasonable investors and violates § 10(b).

The structure of the securities laws provides no support for petitioner's position. Section 10(b) of the 1934 Act broadly prohibits "any manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b). That language encompasses the more specific types of misleading conduct enumerated in § 11 of the 1933 Act, including "omitt[ing] to state a material fact required to be stated [in a registration statement] or necessary to make the statements therein not misleading." *Id.* § 77k(a). Nothing in the statutory text or structure indicates that Congress intended to exclude from § 10(b)'s reach the type of deception at issue here.

This Court's statements to the effect that "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5" were made in cases where, unlike here, no SEC regulation required disclosure of the omitted information. *Basic*, 485 U.S. at 239 n.17; *see Matrixx*, 563 U.S. at 44. As the Commission explained in its brief in *Basic*, "[d]isclosure *is* required . . . where regulations promulgated by the Commission require disclosure." Br. for the SEC as Amicus Curiae at 7, No. 86-279 (U.S. filed Apr. 30, 1987) ("SEC *Basic* Br.") (emphasis added). The Third Circuit likewise recognized in *Oran v. Stafford*, 226 F.3d 275 (3d Cir. 2000) (Alito, J.), that "a duty to disclose may arise when there is . . . a statute requiring disclosure." *Id.* at 285. That is the case here; no party disputes that Regulation S-K validly implements § 13 of the 1934 Act. Nothing in *Basic*, *Matrixx*, or *Oran* supports petitioner's view that § 10(b) does not reach misleading omissions of required, material information in securities filings.

C. Permitting this action to proceed does not transgress the PSLRA as interpreted in *Stoneridge* because "it does not alter the elements of the Rule 10b-5 cause of action and thus maintains the action's original legal scope." *Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S. Ct. 2398, 2412 (2014). This case is heartland securities fraud — a misleading securities filing by a publicly traded company that purports to comply with SEC disclosure rules but omits required, material information.

II. The Second Circuit's decision serves Congress's purpose of promoting disclosure by publicly traded companies. The Commission has long pursued enforcement actions on the ground that "Item 303

can be the basis for a Section 10(b) claim."[6] Although rhetorically couched in terms of private liability, petitioner's position would undoubtedly strip the Commission of power to police the type of fraud at issue here.

None of petitioner's policy arguments justifies construing § 10(b)'s prohibition on deception to exempt petitioner's misleading annual report. Issuers are not encouraged to disclose trivial information because § 10(b) creates liability only for omissions of information that is material under *Basic*. Hindsight-driven litigation is not permitted because investors must establish that the issuer acted with scienter, and Item 303 itself requires disclosure only when the uncertainties are "known" to the issuer. Notably, although petitioner concedes that omissions of required information are actionable under § 11, it has made no showing that the problems it foresees have materialized from many decades of litigation under that provision.

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[6] Pl. SEC's Bench Mem. in Opp. to Def. Conaway's Mot. for J. as a Matter of Law at 5, *SEC v. Conaway*, No. 05-CV-40263-SDP, Dkt. #127 (E.D. Mich. filed May 26, 2009) ("SEC *Conaway* Mem."); *see id.* at 5-11.

ARGUMENT

I. AN ISSUER THAT DECEIVES INVESTORS BY OMITTING REQUIRED INFORMATION FROM AN ANNUAL REPORT FILED WITH THE SEC IS SUBJECT TO LIABILITY UNDER § 10(b)

A. The Deliberate Omission Of Required, Material Information In An Annual Report Is Deceptive

A securities issuer engages in deceptive conduct within the proscriptions of § 10(b) and Rule 10b-5 when it publicly files an annual report on Form 10-K containing an MD&A section that purports to comply with the Commission's rules but in fact deliberately omits material information required under Item 303 of Regulation S-K. That principle derives from the text of § 10(b) and Rule 10b-5, this Court's cases, and investors' reasonable expectations.

1. Section 10(b)'s Text Broadly Proscribes Deceptive Conduct

As pertinent here, § 10(b) of the 1934 Act prohibits "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe." 15 U.S.C. § 78j(b). The Commission's Rule 10b-5 implements § 10(b) by forbidding the use of (a) "any device, scheme, or artifice to defraud"; (b) "any untrue statement of material fact" or the omission of "a material fact necessary in order to make the statements made . . . not misleading"; or (c) any other "act, practice, or course of business" that "operates . . . as a fraud or deceit." 17 C.F.R. § 240.10b-5.

As its text demonstrates, § 10(b) broadly prohibits the use of "any . . . deceptive device or contrivance."

15 U.S.C. § 78j(b). Filing an annual report that deliberately omits required, material information can be "deceptive" within the meaning of § 10(b) because investors can be led to believe (incorrectly) 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.

2. *Omnicare* and *Universal Health* Support Construing § 10(b) and Rule 10b-5 To Cover Deliberate Omissions of Required, Material Information

In two recent cases, this Court has confirmed that material omissions can be misleading. In *Omnicare*, the Court addressed misleading omissions in statements of opinion under § 11 of the 1933 Act, which is similar to Rule 10b-5 in prohibiting the omission of material facts necessary to make statements in a registration statement not misleading. *See* 135 S. Ct. at 1323, 1327 & n.3; 15 U.S.C. § 77k(a). The Court began with the premise that "whether a statement is 'misleading' depends on the perspective of a reasonable investor." 135 S. Ct. at 1327. The Court then explained that "a reasonable investor may, depending on the circumstances, understand an opinion statement to convey facts about how the speaker has formed the opinion." *Id.* at 1328. If "the real facts are otherwise, but not provided, the opinion statement will mislead its audience." *Id.* "Thus," the Court concluded, "if a registration statement omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself, then § 11's omissions clause creates liability." *Id.* at 1329.

This Court took a similar approach to omissions of fact concerning compliance with federal regulations when construing the False Claims Act in *Universal Health*. There, the Court interpreted that Act's prohibition on "fraudulent" claims to cover "misrepresentations by omission." 136 S. Ct. at 1999. The Court invoked "the rule that half-truths — representations that state the truth only so far as it goes, while omitting critical qualifying information — can be actionable misrepresentations." *Id.* at 2000. And it pointed to securities law as an "other statutory context[]" in which it had "used this definition" of fraud. *Id.* at 2000 n.3. To illustrate the half-truths rule, the Court referred to the "classic example" of "the seller who reveals that there may be two new roads near a property he is selling, but fails to disclose that a third potential road might bisect the property." *Id.* at 2000. "The enumeration of two streets" is "a tacit representation that the land to be conveyed was subject to no others." *Id.* As the Court concluded, "'[a] statement that contains only favorable matters and omits all reference to unfavorable matters is as much a false representation as if all the facts stated were untrue.'" *Id.* at 2001 n.4 (quoting Restatement (Second) of Torts § 529 cmt. a (1977)).

3. Deliberate Omissions of Required, Material Information in Annual Reports Are Deceptive

a. A reasonable investor expects that, when a company files an annual report on Form 10-K, the report includes the information required to be disclosed in that report. The structure of an annual report reinforces that expectation. The cover page prominently identifies the report as an "Annual Report Pursuant to Section 13 . . . of the Securities

Exchange Act of 1934." JA816.[7] The report then addresses a list of numbered items that correspond to portions of the Commission's regulations implementing § 13 of the 1934 Act. *See* JA822-967; SEC Form 10-K at 8-11. It ends with certifications by the company's CEO and CFO that the report "fully complies with the requirements of Section 13(a) . . . of the [1934] Act." JA1121-22; *see* 18 U.S.C. § 1350. A reader of a company's annual report therefore reasonably expects the report to contain all material information required to be disclosed by the Commission's regulations implementing § 13.

The omission of required information from an annual report is deceptive when it leads investors to the erroneous conclusion that material omitted facts do not exist. For example, the Commission's regulations require issuers to disclose a variety of information about their directors and executive officers, including whether any of them "was convicted in a criminal proceeding or is a named subject of a pending criminal proceeding (excluding traffic violations and other minor offenses)." 17 C.F.R. § 229.401(f)(2); *see* SEC Form 10-K at 10 (Item 10). If a company's annual report appears to provide the information about directors and officers required by the Commission's rule, and discloses nothing regarding criminal convictions or proceedings, a reader of the report would reasonably conclude that none of the company's officers and directors has a criminal record. If the CFO was in fact under indictment for fraud, the omission of that information would be deceptive.[8]

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[7] *See also* SEC Form 10-K at 6, https://www.sec.gov/files/2017-03/form10-k.pdf.

[8] *See* Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 Vand. L. Rev. 1639, 1680

Not all omissions of required information would be deceptive in this way. For example, the company in the above example could expressly state in the report that it is not disclosing all required information regarding the criminal records of its directors and officers. Such an acknowledgement would likely trigger other enforcement issues for the company, but it would at least alert investors to the omission and likely prevent them from inferring that the omitted facts do not exist. *See* Langevoort, 57 Vand. L. Rev. at 1681. As the Court recognized in *Zandford*, "if [a] broker told his client he was stealing the client's assets, that breach of fiduciary duty might be in connection with a sale of securities, but it would not involve a deceptive device or fraud." 535 U.S. at 825 n.4 (citing *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 474-76 (1977)); *see O'Hagan*, 521 U.S. at 655 ("full disclosure forecloses liability"). The key to the deception at issue here is the unspoken, deliberate omission of facts that, if they exist, a reasonable investor would expect to be stated in the report.

b. The deliberate omission of required information is particularly likely to be deceptive when it concerns the MD&A, which describes management's assessment of the company's financial condition and prospects. Item 303 is "[o]ften the most important textual disclosure item in Regulation S-K." II Louis Loss et al., *Securities Regulation* 224 (5th ed. 2014); *see* Thomas Lee Hazen, *The Law of Securities Regulation* 125 (7th ed. 2017) (describing MD&A as

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(2004) (explaining that "a deliberate omission" in an SEC filing has the "potential to mislead" because "the reader of the disclosure sees that the issuer is responding to the disclosure obligation and is entitled to assume that the response is not only accurate but complete as well").

"particularly important"). The MD&A is "intended to provide, in one section of a filing," information enabling investors "to assess the financial condition and results of operations of the registrant, with particular emphasis on the registrant's prospects for the future." 54 Fed. Reg. at 22,428. The aspect of the MD&A at issue here — the requirement to identify known trends and uncertainties — is "[o]ne of the most important elements necessary to an understanding of a company's performance, and the extent to which reported financial information is indicative of future results." Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, 68 Fed. Reg. 75,056, 75,061 (Dec. 29, 2003).

An investor therefore reasonably expects to review a company's MD&A and see, in "one section of a filing," 54 Fed. Reg. at 22,428, a discussion enabling her to "ascertain the likelihood that past performance is indicative of future performance," 68 Fed. Reg. at 75,056. Petitioner's own 16-page MD&A section was certainly designed to create the impression that it contained all of the information required to be disclosed therein. When an MD&A identifies no known trends or uncertainties that are reasonably expected to have a material impact, or describes some such trends or uncertainties, a reasonable investor would assume that no unidentified trends or uncertainties exist. If the issuer is aware of other qualifying trends or uncertainties and fails to disclose them, its deliberate omission of that required information is deceptive. Such conduct thus falls within § 10(b)'s prohibition of any "deceptive device or contrivance."

4. The Deliberate Omission of Material Information Required in an Annual Report Implicates Each of the Three Prongs of Rule 10b-5

An issuer that deceives investors by deliberately omitting required, material information from its annual report violates each of the three prongs of Rule 10b-5, which this Court has explained is "coextensive with the coverage of § 10(b)," *Zandford*, 535 U.S. at 816 n.1.

a. The deliberate omission of required information triggers Rule 10b-5's prohibition on the omission of "a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading." 17 C.F.R. § 240.10b-5(b). When an issuer discloses some but not all of the material facts required to be disclosed under Item 303, the MD&A creates the misleading impression that there are no omitted material facts that Item 303 would require the issuer to disclose. The "'enumeration of'" certain facts required to be disclosed in the MD&A is "'a tacit representation'" that no undisclosed facts exist. *Universal Health*, 136 S. Ct. at 2000 (quoting *Junius Constr. Co. v. Cohen*, 178 N.E. 672, 674 (N.Y. 1931) (Cardozo, J.)). Under those circumstances, disclosure of the omitted facts is necessary to make the statements in the MD&A not misleading. *See id.* at 2001 n.4.

A "reasonable investor" would take from an annual report on Form 10-K that the company has disclosed the information required by the Commission's regulations, unless the report disclaims making the mandatory disclosures. As the *Omnicare* Court noted, "context" matters: annual reports, like registration statements, "as a class are formal documents,

filed with the SEC." 135 S. Ct. at 1330. Just as reasonable investors "do not, and are right not to, expect opinions contained in [registration] statements to reflect baseless, off-the-cuff judgments," *id.*, reasonable investors expect that annual reports will not omit material, required information.

The Second Circuit recognized this point in *Stratte-McClure v. Morgan Stanley*, 776 F.3d 94 (2d Cir. 2015). It explained that "SEC regulations, like Item 303, dictate the contents of mandatory disclosures" such as annual reports "and are therefore an essential part of the circumstances under which such disclosures are made." *Id.* at 104. Rule 10b-5's text expressly requires consideration of such "circumstances under which" a statement was "made." 17 C.F.R. § 240.10b-5(b). As the *Stratte-McClure* court explained, "[d]ue to the obligatory nature of [Regulation S-K], a reasonable investor would interpret the absence of an Item 303 disclosure to imply the nonexistence of 'known trends or uncertainties . . . that the registrant reasonably expects will have a material . . . unfavorable impact on . . . revenues or income from continuing operations.'" 776 F.3d at 102 (quoting 17 C.F.R. § 229.303(a)(3)(ii)) (ellipses in original). Thus, if the MD&A section of an annual report omits material facts required under Regulation S-K, reasonable investors will conclude that those facts did not exist, and the report will thereby "mislead its audience." *Omnicare*, 135 S. Ct. at 1328.

b. When the other elements of a violation (scienter and materiality under *Basic*) are present, as they are here, the filing of an MD&A disclosure that omits required material facts also constitutes both a "device, scheme, or artifice to defraud" and an "act, practice, or course of business" that "operates . . .

as a fraud or deceit." 17 C.F.R. § 240.10b-5(a), (c). In *Stoneridge*, this Court rejected as "erroneous" the proposition that "there must be a specific oral or written statement before there could be liability under § 10(b) or Rule 10b-5," explaining that "[c]onduct itself can be deceptive." 552 U.S. at 158.

"Deception through nondisclosure," *O'Hagan*, 521 U.S. at 654, violates § 10(b) and Rule 10b-5(a) and (c). In *O'Hagan*, the Court held that a stranger to the issuer — "a corporate 'outsider'" — committed securities fraud by trading on nonpublic information in breach of a duty owed to the source of the information. *See id.* at 650-66. Such a "misappropriator," the Court explained, "gains his advantageous market position through deception," *id.* at 656, and thereby engages in conducted prohibited by § 10(b), *id.* at 653-55; *see also id.* at 651 (relying on prongs (a) and (c) of Rule 10b-5); *Salman v. United States*, 137 S. Ct. 420, 423 (2016) (same).

The Court has applied the principle that deception violates Rule 10b-5(a) and (c) beyond the insider-trading context. In *Zandford*, the Court held that a broker violates § 10(b) and Rule 10b-5 by selling customers' securities and misappropriating the proceeds. *See* 535 U.S. at 819 (citing Rule 10b-5(a) and (c)); *id.* at 820-25. Each sale is "made to further [the broker's] fraudulent scheme," and each is "deceptive because it was neither authorized by, nor disclosed to, the [customers]." *Id.* at 820-21. The court of appeals in *Zandford* had emphasized that the broker was not accused of making "an affirmative misrepresentation," but instead of "simply fail[ing] to inform the [customers] of his intent to misappropriate their securities." *Id.* at 822. This Court was "not persuaded by this distinction" because the broker

"was only able to carry out his fraudulent scheme without making an affirmative misrepresentation because the [customers] had trusted him to make transactions in their best interest without prior approval." *Id.* This case is analogous: an issuer that deliberately omits required information from its annual report is able to deceive investors because they expect companies to provide the Commission-mandated disclosures in annual reports.

The Court has also applied § 10(b) to deception where no "fiduciary-type" relationship existed. In *Wharf (Holdings) Ltd. v. United International Holdings, Inc.*, 532 U.S. 588 (2001), the Court held that a defendant violated § 10(b) when it sold an option to purchase a 10% interest in a business with a "secret intent not to honor the option." *Id.* at 594. Without specifying a particular prong of Rule 10b-5, the Court held that the rule covered the misconduct at issue, reasoning that "[t]o sell an option while secretly intending not to permit the option's exercise is misleading, because a buyer normally presumes good faith." *Id.* at 596. Likewise, to file an annual report while secretly omitting required information is misleading, because an investor normally presumes compliance with the Commission's disclosure regulations.

B. A Company Has No Right To Deceive Investors By Omitting Required Information From Its Annual Report

In recognizing that § 10(b) reaches petitioner's deception, the Second Circuit did not create a previously unheard-of "category of duty." Pet. Br. 19, 28. Rather, it applied the language of § 10(b) and Rule 10b-5, consistent with this Court's decisions. *See supra* Part I.A. Petitioner's criticisms of the Second Circuit's reasoning mischaracterize the complaint's

allegations, misinterpret the securities laws' structure, and misread this Court's decisions in *Basic*, *Matrixx*, and *Oran*.

1. Petitioner's Proposed Exception for So-Called "Pure Omissions" Cases Mischaracterizes the Deception at Issue Here

Petitioner acknowledges that § 10(b) and Rule 10b-5 prohibit "an omission of 'a material fact necessary in order to make the statements made . . . not misleading.'" Pet. Br. 22 (quoting 17 C.F.R. § 240.10b-5(b)). Seeking to avoid the import of that rule, petitioner mischaracterizes this case as involving only a "pure omission." *Id.* But petitioner filed an annual report that, while purporting to provide the information required by the Commission's regulations, in fact deliberately omitted required information. Indeed, petitioner's March 2011 annual report noted as a "risk factor" the company's heavy reliance on government contracts and warned that, if its "reputation or relationships with" agencies were harmed (including through "employee or subcontractor misconduct"), its future prospects would suffer. JA847-48. Yet it omitted the material fact that the ongoing CityTime scandal could have — and was having — that effect.

That is deception, not "pure omission." Petitioner's failure to disclose known problems and uncertainties regarding the CityTime project cannot reasonably be described as a "pure omission" any more than could the failure of the seller of land to disclose that third planned road through his property. *See Universal Health*, 136 S. Ct. at 2000.

Petitioner also concedes (at 25-27) that this Court's precedents establish that an omission violates § 10(b) and Rule 10b-5 when one has "a fiduciary-type duty

to disclose material information." But it never explains why, in its view, a common-law "fiduciary-type" duty suffices for liability under § 10(b) and Rule 10b-5, but a Commission regulation validly implementing § 13's disclosure obligation is irrelevant to liability under those provisions. A disclosure duty, regardless of its source, matters because it shapes the reasonable expectations of investors. *See Zandford*, 535 U.S. at 822. The withholding of information that investors would expect to see in a securities filing — because the SEC requires that information to be disclosed therein — is deceptive, and therefore falls squarely within § 10(b)'s and Rule 10b-5's prohibition.

Petitioner emphasizes (at 25) that "none" of this Court's "fiduciary-type duty" cases involved "issuers" as defendants. That fact is significant, but not for the reason petitioner implies. The defendants in those cases were strangers to the issuers and generally had no obligations to disclose information to investors. It was therefore important in those cases to identify "a duty of trust and confidence" that triggered the obligation to disclose (or abstain from trading based on) the material nonpublic information. *Salman*, 137 S. Ct. at 423. Issuers, by contrast, are the object of the 1934 Act's disclosure regime. *See*, *e.g.*, 15 U.S.C. § 78m(a)(2) ("[e]very issuer . . . shall file . . . such annual reports" as the Commission requires). Congress intended the securities laws to require greater disclosure to investors *by issuers*. An issuer therefore is the last person Congress and the Commission would have intended to absolve from liability for "[d]eception through nondisclosure." *O'Hagan*, 521 U.S. at 654.

2. The Structure of the Securities Laws Provides No Support for Petitioner's Position

Contrasting the language of § 10(b) with that of § 11 of the 1933 Act provides no support for petitioner's position. *Cf.* Pet. Br. 29-30. Section 11 creates civil liability when a registration statement "contain[s] an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a). According to petitioner (at 30), the inclusion in § 11 of language prohibiting the omission of "a material fact required to be stated" in a registration statement means that § 10(b)'s antifraud prohibition must be read to exclude "omitting information required by regulation."

Section 10(b)'s scope cannot be constrained in the way petitioner posits because its text is different from and much broader than § 11. Section 10(b) reaches "any manipulative or deceptive device or contrivance." 15 U.S.C. § 78j(b). Unlike § 11, that language is not limited to particular types of statements and omissions. Congress gave no textual indication that it intended to treat the fraudulent omission of material information required in an annual report as any less of a "deceptive device or contrivance" than a straight misrepresentation.

Rule 10b-5, which is "coextensive with the coverage of § 10(b)," *Zandford*, 535 U.S. at 816 n.1, likewise prohibits not only omitting material facts necessary to make statements not misleading, but also "any device, scheme, or artifice to defraud" and "any act" that "operates" as "a fraud or deceit." 17 C.F.R. § 240.10b-5. Those broad prohibitions on misleading and fraudulent conduct plainly encompass the type of

deception at issue here — filing an annual report that purports to comply with mandatory disclosure provisions but in fact omits required, material facts.

The additional differences between civil liability under § 11 and § 10(b) only reinforce that conclusion. *Cf.* Pet. Br. 30-31. Section 11's right of action is potent; there is no scienter requirement, so liability "is virtually absolute, even for innocent misstatements." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 382 (1983) (footnote omitted). But that right of action is "limited in scope." *Id.* Among other restrictions, "a § 11 action must be brought by a purchaser of a registered security, must be based on misstatements or omissions in a registration statement, and can only be brought against certain parties." *Id.*

Section 10(b), by contrast, "is a 'catchall' antifraud provision." *Id.* An action under § 10(b) "can be brought by a purchaser or seller of '*any* security' against '*any* person' who has used '*any* manipulative or deceptive device or contrivance' in connection with the purchase or sale of a security." *Id.* (quoting 15 U.S.C. § 78j) (emphases in *Huddleston*). Although § 10(b) prohibits an even broader swath of deceptive conduct than does § 11, "a § 10(b) plaintiff carries a heavier burden than a § 11 plaintiff" in that "he must prove that the defendant acted with scienter," among other elements. *Id.*; *see Hochfelder*, 425 U.S. at 200, 210 (rejecting § 10(b) liability based on negligence). Nothing in § 11 supports reading § 10(b) to exclude the deception at issue here.

Petitioner's comparisons (at 31-32) to § 9 and § 18 of the 1934 Act are even less persuasive. Neither of those provisions covers omissions of facts necessary to make statements not misleading — omissions that petitioner concedes are within the scope of § 10(b).

Petitioner cites no authority for narrowly construing the scope of conduct prohibited by § 10(b) to match the scope of § 9 or § 18. It quotes from *Touche Ross & Co. v. Redington*, 442 U.S. 560 (1979), but that case involved whether to imply a private right of action under § 17(a) of the 1934 Act, not the scope of § 10(b). *Cf. Halliburton*, 134 S. Ct. at 2409 (rejecting argument that the reliance element of a § 10(b) private action should be limited by § 18).

3. *Basic*, *Matrixx*, and *Oran* Support the Second Circuit's Rule

Petitioner also misreads this Court's decisions in *Basic* and *Matrixx*, as well as the Third Circuit's ruling in *Oran*, as establishing a right to remain silent with respect to information required to be disclosed by an SEC regulation.

a. *Basic* addressed the standard for materiality under § 10(b) and Rule 10b-5, describing the test as whether a "reasonable investor" would have viewed omitted information "as having significantly altered the 'total mix' of information made available." 485 U.S. at 231-32. Applying that standard to corporate merger negotiations, the Court rejected the issuer's contention that merger discussions do not become material until an "agreement-in-principle" exists. *Id.* at 233. It held instead that even preliminary merger discussions — and other "contingent or speculative information or events" — can be material, depending on "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." *Id.* at 238.

In a footnote, the *Basic* Court noted that, "[t]o be actionable, of course, a statement must also be misleading." *Id.* at 239 n.17. It added that "[s]ilence,

absent a duty to disclose, is not misleading under Rule 10b-5." *Id.* To support that proposition, the Court cited SEC guidance stating that issuers were generally not required to disclose preliminary merger negotiations.[9] The Commission's brief in *Basic* confirmed that "a company generally has no affirmative duty under the federal securities laws to disclose ongoing merger activity." SEC *Basic* Br. 7. It explained, however, that "[d]isclosure *is* required" in certain circumstances, including "where regulations promulgated by the Commission require disclosure." *Id.* (emphasis added); *see id.* at 7 n.3 (discussing regulations requiring disclosure of merger negotiations under certain conditions).[10]

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[9] *See In re Carnation Co.*, 33 SEC Dkt. 874, 877 n.6 (July 8, 1985) ("[A]n issuer that wants to prevent premature disclosure of nonpublic preliminary merger negotiations can, in appropriate circumstances, give a 'no comment' response to press inquiries concerning rumors or unusual market activity."), *cited in Basic*, 485 U.S. at 239 n.17.

[10] The *Basic* Court acknowledged the existence of multiple duties to disclose. In rejecting a different standard of materiality for insider-trading cases, the Court explained that

> [d]evising two different standards of materiality, one for situations where insiders have traded in abrogation of their duty to disclose or abstain (or for that matter when any disclosure duty has been breached), and another covering affirmative misrepresentations by those under no duty to disclose (but under the ever-present duty not to mislead), would effectively collapse the materiality requirement into the analysis of defendant's disclosure duties.

485 U.S. at 240 n.18. In that sentence, the Court referred to at least three sources of a duty to disclose — (1) the "duty to disclose or abstain"; (2) "the ever-present duty not to mislead"; and (3) "any disclosure duty" that might "be[] breached." *Id.* Although petitioner (at 21) premises its theory of the case in part on this footnote, it fails to reconcile the Court's discussion with its two-duty taxonomy.

Here, unlike in *Basic*, "regulations promulgated by the Commission require disclosure." *Id.* at 7. In implementing § 13 of the 1934 Act, the Commission has determined by regulation that an issuer must disclose known trends or uncertainties that are reasonably likely to have a material impact on its business. An issuer that files an annual report that purports to comply with the Commission's regulations but fails to disclose such known trends or uncertainties has gone well beyond mere "[s]ilence." *Basic*, 485 U.S. at 239 n.17. It has deceived investors, and nothing in *Basic* suggests otherwise.

b. *Matrixx* is likewise no help to petitioner. There, a drug manufacturer failed to disclose adverse events regarding a key product. It argued that the omitted information was not material under *Basic* because the number of adverse events was not statistically significant. This Court rejected that argument, explaining that the manufacturer's "categorical rule would 'artificially exclud[e]' information that 'would otherwise be considered significant to the trading decision of a reasonable investor.'" 563 U.S. at 40 (quoting *Basic*, 485 U.S. at 236) (brackets in *Matrixx*).

The *Matrixx* Court reassured issuers that "§ 10(b) and Rule 10b-5(b) do not create an affirmative duty to disclose any and all material information." *Id.* at 44. Rule 10b-5(b) — the only portion of the rule at issue there — requires disclosure, the Court explained, only when necessary to make statements made not misleading. *Id.* *Matrixx* involved no claim, however, that the Commission by regulation had required drug manufacturers to disclose the adverse events at issue in a periodic report. The case therefore did not concern a claim that a reasonable investor would have been deceived by a periodic report that omitted required information.

The Commission's brief in *Matrixx* confirmed that the drug manufacturer was not required to make the overly optimistic statements "about the safety and prospects of its product" that triggered liability there. Br. for the U.S. as Amicus Curiae Supporting Respondents at 27, No. 09-1156 (U.S. filed Nov. 12, 2010) ("U.S. *Matrixx* Br."). Petitioner misleadingly asserts (at 23-24) that the Commission made that statement "even though some of the disclosures at issue were required to be made in the defendant's 10-Q." In fact, most of the manufacturer's statements were made in press releases and conference calls. *See* U.S. *Matrixx* Br. 4-6. The one statement in a Form 10-Q was a half-truth related to product-liability litigation, not "the safety and prospects of its product." *Id.* at 27; *see id.* at 5 ("Matrixx stated [in the 10-Q] that even a single unmeritorious product liability claim 'could materially adversely affect our results of operations and financial condition.' Matrixx did not disclose that it had already been sued by two plaintiffs who claimed to have suffered anosmia due to Zicam use.") (citation omitted).

c. *Oran* undermines, not supports, petitioner's position. *Cf.* Pet. Br. 27-28, 35, 37. There, the Third Circuit recognized that "a duty to disclose may arise when there is . . . a statute requiring disclosure." 226 F.3d at 285 (Alito, J.). "[R]egulations, if valid and reasonable, authoritatively construe the statute itself." *Alexander v. Sandoval*, 532 U.S. 275, 284 (2001). The disclosure duty arising from § 13 of the 1934 Act therefore encompasses Regulation S-K, which validly implements § 13.

The Third Circuit also correctly recognized that Item 303 may require issuers to disclose information that is not material under *Basic*. *See* 226 F.3d at

287-88. The omission of such information would be a violation of Regulation S-K, but not fraud actionable under § 10(b). Thus, as the *Oran* court concluded: "a violation of [Item 303's] reporting requirements does not automatically give rise to a material omission under Rule 10b-5." *Id.* at 288. Rather, the misleading omission of information required to be disclosed by Item 303 subjects the issuer to fraud liability under § 10(b) only when the omitted information *is* material under *Basic*, and the other requirements for liability are met.

C. The PSLRA Does Not Limit The Scope Of Deception Prohibited By § 10(b)

1. The PSLRA Provides No Immunity for Petitioner's Deception

Petitioner relies (at 24) on a provision of the PSLRA that establishes pleading standards for private actions "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 . . . not misleading." 15 U.S.C. § 78u-4(b)(1). In such a case, the complaint must "specify each statement alleged to have been misleading" and "the reason or reasons why the statement is misleading." *Id.* According to petitioner (at 24), that provision exclusively catalogues the available theories of private § 10(b) liability, and a "pure omission claim cannot satisfy" those pleading standards.

Petitioner misreads the statute. By its terms, the provision cited by petitioner applies only to certain specified private actions — namely, "any private action . . . in which the plaintiff alleges that" the defendant made a false statement or omitted a material fact necessary to make statements made not

misleading. 15 U.S.C. § 78u-4(b). That provision contains no language suggesting an intent to cover all possible theories of private liability. It plainly does not extend, for example, to violations of the "fiduciary-type duty" to disclose or refrain, a circumstance that even petitioner concedes (at 25) gives rise to private liability.

Nor does the PSLRA's text extend to claims based on other types of deceptive conduct. The *Stoneridge* Court rejected as "erroneous" the premise that "there must be a specific oral or written statement before there could be liability under § 10(b) or Rule 10b-5." 552 U.S. at 158. *Stoneridge* thus confirms that, by establishing pleading requirements for one type of private § 10(b) claim, Congress did not foreclose claims involving other types of deceptive devices or contrivances.

In any event, an investor can readily comply with the PSLRA's pleading requirements when alleging a claim based on the fraudulent omission of required information. A private plaintiff alleging such a claim can specify the statements that were rendered misleading by the omission of required facts (such as the statements in the MD&A, for example) and why the omission made those statements misleading. That is what respondents did here. PSAC ¶¶ 5, 455, 496, 499, 527, 564 (JA55, JA244-45, JA263-65, JA282, JA310-11). Petitioner did not argue otherwise in the Second Circuit. Pet. C.A. Br. 43-45.

2. The PSLRA Did Not Freeze in Place the Scope of Frauds Actionable Under § 10(b)

a. Petitioner mischaracterizes *Stoneridge* (at 32-36) as "foreclos[ing]" any theory of liability that had not been expressly recognized in judicial decisions

before the PSLRA's enactment. *Stoneridge* rejected § 10(b) liability for entities acting as the issuer's customers and suppliers — "secondary actor[s]" — because the investor plaintiffs did not "rely upon" the defendants' "own deceptive conduct." 552 U.S. at 158, 160. A contrary result, the Court explained, "would put an unsupportable interpretation on Congress' specific response" to this Court's rejection of secondary liability in *Central Bank*. *Id.* at 162. Congress had responded to *Central Bank* in the PSLRA by authorizing aiding-and-abetting liability "in actions brought by the SEC but not by private parties." *Id.* The *Stoneridge* plaintiffs' claim conflicted with that determination, the Court concluded, because their "view of primary liability makes any aider and abettor liable." *Id.* Petitioner is no "secondary actor"; it is the issuer that filed the deceptive annual report in question. The Second Circuit's ruling is thus entirely consistent with the PSLRA as interpreted in *Stoneridge*.

Stoneridge provides no support for petitioner's sweeping theory that the types of deception prohibited by § 10(b) were frozen in time at the PSLRA's enactment. "In *Central Bank* and *Stoneridge*," this Court "declined to extend Rule 10b-5 liability to entirely new categories of defendants" because doing so "would have eviscerated the requirement" that a plaintiff prove reliance on deception "*by the defendant*." *Halliburton*, 134 S. Ct. at 2412. The *Halliburton* Court explained that adhering to the presumption of reliance established in *Basic* did not transgress the PSLRA or *Stoneridge* because "it does not alter the elements of the Rule 10b-5 cause of action and thus maintains the action's original legal scope." *Id.* Here, too, nothing in the Second Circuit's

decision "alter[ed] the elements of" the § 10(b) action or expanded its "original legal scope."[11]

Petitioner's theory of the PSLRA also cannot be squared with this Court's post-PSLRA decision in *Wharf*. In that private § 10(b) action, the Court confronted a question of first impression regarding whether selling an option while secretly intending not to honor it violates § 10(b) and Rule 10b-5. *See* 532 U.S. at 589-90, 592. The Court answered that question in the affirmative without any suggestion that the PSLRA precluded the Court from recognizing that theory of liability. *See id.* at 592-97.[12] Indeed, in observing that the defendant had not "shown us that its concern" about expanding § 10(b) liability "has proved serious as a practical matter in the past," this Court cited a 1984 court of appeals decision that it described only as "suggesting" that the conduct at issue violates § 10(b). *Id.* at 597. The Court did not ask, as petitioner insists (at 34) should be done here, whether courts of appeals "had actually held" that the conduct violates the statute.

b. In any event, petitioner exaggerates (at 32-34) the state of the law before the PSLRA's enactment. Petitioner cites no pre-PSLRA case holding that

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[11] Petitioner mischaracterizes *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. 135 (2011), as standing for the proposition that the PSLRA requires "a particular 'theory of liability'" to have been "established before the PSLRA." Pet. Br. 10 (quoting *Janus*, 564 U.S. at 146). What the Court in fact said was that it would not "read into Rule 10b-5 a theory of liability" for controlling persons that was broader than what Congress expressly provided elsewhere in the 1934 Act. *Janus*, 564 U.S. at 146.

[12] Although the complaint in *Wharf* had been filed before the PSLRA's enactment, this Court gave no indication that future cases could not be pursued based on the same theory of liability.

omitting required, material information in a securities filing can never be deceptive within the meaning of § 10(b). The decisions on which petitioner relies (none from this Court) reject a free-standing "affirmative duty to disclose all material information even if there is no insider trading, no statute or regulation requiring disclosure, and no inaccurate, incomplete, or misleading prior disclosures." *Roeder v. Alpha Indus., Inc.*, 814 F.2d 22, 27 (1st Cir. 1987).[13]

Those decisions reflect that Congress and the Commission have adopted a system of periodic reporting of specific types of information, not continuous disclosure of all material information.[14] But, as the Commission recognized in 1987 in a private § 10(b) suit, "[d]isclosure is required . . . where regulations promulgated by the Commission require disclosure." SEC *Basic* Br. 7.[15] Reasonable investors expect

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[13] *See Fortson v. Winstead, McGuire, Sechrest & Minick*, 961 F.2d 469 (4th Cir. 1992) (no regulation requiring disclosure; defendant was law firm, not issuer); *Staffin v. Greenberg*, 672 F.2d 1196 (3d Cir. 1982) (no indication that regulation required issuer to disclose withheld information), *abrogated by Basic*, 485 U.S. 224; *Schlanger v. Four-Phase Sys., Inc.*, 582 F. Supp. 128, 132-33 (S.D.N.Y. 1984) (no regulation requiring disclosure; dictum).

[14] *See* VII Loss, *Securities Regulation* 595 (5th ed. 2017) ("As a general matter in federal securities law, there is no affirmative duty to disclose unless (1) a Commission statute or rule requires disclosure, (2) an *insider* (or the issuer itself) is trading, or (3) a previous disclosure is or becomes inaccurate, incomplete, or misleading.").

[15] Before 1995, when the PSLRA was enacted, courts had adjudicated § 10(b) claims predicated on the omission of information required under Item 303. *See Ferber v. Travelers Corp.*, 802 F. Supp. 698, 711 (D. Conn. 1992) (discussing Item 303 claim, but holding that trend of increasing mortgage delinquencies was adequately disclosed); *In re Bell Atl. Corp. Sec. Litig.*, Nos.

compliance with those regulations. When an issuer files an annual report that purports to comply with those regulations but in fact omits required facts, investors can be deceived, and the issuer is subject to liability under § 10(b). Nothing in the PSLRA is to the contrary.

3. The Absence of a Private Right of Action To Enforce Regulation S-K Does Not Limit the Scope of § 10(b) Liability

The absence of a right of action to enforce Regulation S-K directly does not mean that § 10(b)'s antifraud prohibition excludes deceptive omissions of information required to be disclosed under that regulation. *Cf.* Pet. Br. 36-41. All agree that "a private damages action" exists under § 10(b) and Rule 10b-5, *Dura*, 544 U.S. at 341 — a right of action that Congress "ratified" in the PSLRA, *Stoneridge*, 552 U.S. at 165. In *Sandoval*, by contrast, "no such right of action exist[ed]" to enforce the regulation at issue there. 532 U.S. at 293. Establishing a violation of Regulation S-K by itself does not establish liability

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91-0514 et al., 1991 WL 234236, at *1 n.3, *8-9 (E.D. Pa. Oct. 30, 1991) (discussing Item 303 claim, but holding that filings adequately disclosed the allegedly omitted trend), *rev'd*, 993 F.2d 875 (3d Cir. 1993) (table), *granting summ. j. on remand*, 1997 WL 205709, at *8 nn.35 & 41, *22 n.80 (E.D. Pa. Apr. 17, 1997), *aff'd*, 142 F.3d 427 (3d Cir. 1998) (table).

Less than five months after the PSLRA was enacted, the First Circuit held that the omission of information required under Item 303 supported a § 10(b) claim. *See Shaw v. Digital Equip. Corp.*, 82 F.3d 1194, 1205, 1211, 1221-22 & n.37 (1st Cir. 1996). In doing so, the court cited pre-PSLRA authority for the proposition that SEC regulations may create a duty to disclose for § 10(b) purposes. *Id.* at 1222 n.37. Petitioner observes (at 34-35) that *Shaw* involved a "public offering," but offers no reason why its position could be limited to claims by "aftermarket investors."

in a § 10(b) action. Rather, a plaintiff must prove deception, meaning that the failure to disclose required information was misleading under the circumstances, in addition to the other elements of a private § 10(b) claim: materiality under *Basic*, scienter, reliance, loss causation, and damages. Imposing liability when those elements have been satisfied enforces § 10(b)'s and Rule 10b-5's prohibition on deception and fraud, not Regulation S-K.

II. ENFORCING LIABILITY FOR DECEPTIVE OMISSIONS OF REQUIRED INFORMATION ADVANCES CONGRESS'S POLICY OF DISCLOSURE

The text of § 10(b) and Rule 10b-5, as well as this Court's cases, demonstrate that issuers are subject to liability for deceptive omissions of required information in annual reports. *See supra* Part I. Petitioner and its *amici* oppose that conclusion on "policy" grounds. But they get the policy wrong. The 1934 Act serves the "fundamental purpose" of implementing "a philosophy of full disclosure." *Kokesh*, 137 S. Ct. at 1640 n.1. Accepting petitioner's theory would seriously undermine Congress's pro-disclosure purpose by eliminating not only private liability but also government enforcement of fraudulent omissions of required information.

Petitioner's policy arguments also are directed to the wrong Branch. "[C]reating an exception to a regulatory scheme founded on a prodisclosure legislative philosophy, because complying with the regulation might be 'bad for business,' is a role for Congress, not this Court." *Basic*, 485 U.S. at 239 n.17. And Congress "has in fact responded" to concerns such as those petitioner expresses by, among other things, enacting the PSLRA. *Halliburton*, 134

S. Ct. at 2413. None of petitioner's concerns justifies construing § 10(b)'s prohibition on deception to exclude deceptive omissions of required information in annual reports.

A. Accepting Petitioner's Theory Would Undermine The Commission's Ability To Deter And Punish Fraud

1. Although petitioner frames its rhetoric in terms of private liability, accepting its position would undoubtedly strip the Commission of power to police the type of fraud at issue here. In petitioner's view, the language of § 10(b) and Rule 10b-5 does not cover "omitting information required by regulation." Pet. Br. 30; *see id.* at 22-23. Petitioner acknowledges (at 48) that its argument targets the "falsity" element of a § 10(b) violation, not any of the elements unique to private liability under § 10(b). Petitioner's analysis therefore leaves no room for the Commission (or the Department of Justice) to enforce § 10(b) against a company that fraudulently omits required information in a securities filing.

Accepting petitioner's theory would deny the Commission an important enforcement tool. The Commission's settled position is that "Item 303 can be the basis for a Section 10(b) claim."[16] It has pursued numerous enforcement actions against issuers that fraudulently failed to disclose information

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[16] SEC *Conaway* Mem. 5; *see id.* at 5-11; Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,726 n.86 (Aug. 24, 2000) ("reporting requirements under Section 13(a) . . . create a duty to disclose for purposes of Rule 10b-5"); Regulation of Takeovers and Security Holder Communications, 63 Fed. Reg. 67,331, 67,336 (Dec. 4, 1998) (duty to disclose triggered by "line-item disclosure requirements in filings with the Commission"); *see also SEC v. Conaway*, 698 F. Supp. 2d 771, 834 (E.D. Mich. 2010).

required under Item 303,[17] typically combining the § 10(b) claim with claims under § 13 or other provisions. A ruling for petitioner would eliminate the Commission's ability to pursue fraud claims in cases of this type.

The Commission also regularly pursues § 10(b) claims based on the fraudulent omission of information required under other disclosure provisions.[18]

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[17] *See*, *e.g.*, *SEC v. Bankatlantic Bancorp, Inc.*, No. 12-60082-Civ., 2012 WL 1936112, at *6, *12-13 (S.D. Fla. May 29, 2012) (in pleading § 10(b) claim, SEC sufficiently alleged failure to disclose in MD&A trend of extending and downgrading loans to housing developers); *In re Presstek, Inc.*, Release No. 997, 1997 WL 784548, at *13 (Dec. 22, 1997) (settling § 10(b) and § 13(a) claims based, in part, on failure to report large, unusual one-time payments as required by Item 303); *In re Cypress Bioscience Inc.*, Release No. 817, 1996 WL 531656, at *6-9 (Sept. 19, 1996) (settling § 10(b), § 13(a), and § 17(a) claims based in part on failure to disclose impact that pre-purchase program would have on future revenues as required by Item 303); *In re Valley Sys. Inc.*, Release No. 707, 1995 WL 547801, at *4-5 (Sept. 14, 1995) (settling § 10(b) and § 13(a) claims based in part on failure to disclose the deliberate underpayment of workers compensation expenses as source of liquidity, as required by Item 303); *In re Westwood One, Inc.*, Release No. 521, 1994 WL 19140, at *10-13 (Jan. 19, 1994) (settling § 10(b) and § 13(a) claims based in part on failure to disclose barter deals and changes in accounting methods as required by Item 303).

[18] *See*, *e.g.*, *SEC v. Kovzan*, 807 F. Supp. 2d 1024, 1037 (D. Kan. 2011) (failure to disclose company's payments to CEO for lavish personal expenses, as required by 17 C.F.R. § 229.402 (Item 402)); *SEC v. Saltsman*, No. 07-CV-4370 (NGG)(RML), 2016 WL 4136829, at *12-14 (E.D.N.Y. Aug. 2, 2016) (failure to disclose related-party transactions under 17 C.F.R. § 229.404); *SEC v. Das*, No. 8:10CV102, 2010 WL 4615336, at *7-8 (D. Neb. Nov. 4, 2010) (failure to disclose valuable perks and related-party transactions as required by Items 402 and 404); *In re Ciro Inc.*, Release No. 612, 1994 WL 548994, at *5 (Sept. 30, 1994) (failure to disclose CEO's bankruptcy as required by 17 C.F.R. § 229.401).

These provisions require disclosure of important information about material off-balance-sheet arrangements, officers' prior convictions and bankruptcies, transactions with related persons, and other information vital to investment decisions. *See*, *e.g.*, 17 C.F.R. §§ 229.101(c)(1)(xii), 229.103, 229.303(a)(2)(ii), 229.401(d), (f), 229.404(a). As petitioner recognizes (at 40), its theory has no limiting principle that would restrict its impact on the Commission's enforcement prerogatives to Item 303 cases.

2. The prospect of liability under § 10(b) and Rule 10b-5 provides a critical complement to the Commission's other efforts to promote issuer compliance with disclosure obligations. Removing that prospect would undermine the Commission's informal disclosure measures, which petitioner purports to support (at 42-44). Those informal efforts work precisely because they are backed up with the threat of government enforcement actions and private liability. Curtailing the Commission's enforcement powers is no way to encourage productive issuer engagement with the Commission.

The Commission has never suggested that its informal engagement with issuers is sufficient on its own. On the contrary, it has explained that the process by which the staff of the SEC's Division of Corporate Finance exchanges letters with issuers commenting on the adequacy of the issuers' disclosures "is not a guarantee that the disclosure is complete and accurate."[19] Indeed, Commission staff has informed issuers that the comment-letter process does not foreclose Commission action or offer a defense in an action brought by any person. *See*, *e.g.*,

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[19] SEC Div. of Corp. Fin., Filing Review Process, https://www.sec.gov/divisions/corpfin/cffilingreview.htm (last visited Aug. 25, 2017).

Universal Hosp. Servs., Inc., SEC Staff Comment Letter at 3 (Aug. 15, 2012). The Commission also has continued to express concerns with the quality of issuers' disclosures,[20] confirming the continued importance of the disclosure incentive § 10(b) liability provides.

B. Federal Courts Are Fully Capable Of Adjudicating Fraud Claims Based On Omissions Of Required Information

Petitioner's professed concerns (at 44-54) about over-disclosure and hindsight-driven litigation are unfounded.

1. Courts are more than capable of adjudicating disclosure issues under Item 303. Petitioner's contrary assertions (at 49-50) are particularly puzzling in light of its concession (at 29) that § 11 of the 1933 Act authorizes private actions based on omissions of required information in registration statements. For decades, courts have adjudicated § 11 claims based on violations of Item 303 and other disclosure requirements,[21] in addition to numerous cases over

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[20] *See* Commission's Statement About Management's Discussion and Analysis of Financial Condition and Results of Operations, 67 Fed. Reg. 3746, 3747, 3750 (Jan. 25, 2002) (expressing concerns about a "lack of transparency" in disclosures and that "the quality of information provided by public companies" on certain topics "should be improved"); *see also* Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. 23,916, 23,942 (Apr. 22, 2016) ("Despite Item 303(a)'s instruction to the contrary, many registrants simply recite the amounts of changes from year to year which are readily computable from their financial statements.") (footnote omitted).

[21] *See, e.g.*, *Silverstrand Invs. v. AMAG Pharm., Inc.*, 707 F.3d 95, 102-06 (1st Cir. 2013); *J&R Mktg., SEP v. General Motors Corp.*, 549 F.3d 384, 390-92 (6th Cir. 2008); *Steckman v. Hart Brewing, Inc.*, No. 96-1077-K, 1996 WL 881659, at *3-4 (S.D. Cal. Dec. 24, 1996), *aff'd*, 143 F.3d 1293 (9th Cir. 1998).

the years under § 10(b).[22] Petitioner, however, has made no showing that "its concern[s] ha[ve] proved serious as a practical matter in the past." *Wharf*, 532 U.S. at 597. Nor should those concerns be expected to materialize.

Section 10(b) liability for deceptive omissions of required information will not produce a litany of immaterial, prophylactic disclosures. *Cf.* Pet. Br. 44-47. Any Item 303 fraud case must meet *both* the materiality requirement in Item 303 itself and that of § 10(b). *See Stratte-McClure*, 776 F.3d at 103 ("[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."). Although Item 303 may require disclosure of more information than is material under *Basic*, *see Oran*, 226 F.3d at 288, the scope of private liability turns on the *Basic* standard, which "filter[s] out essentially useless information that a reasonable investor would not consider significant." *Basic*, 485 U.S. at 234. The *Basic* standard also expressly addresses the materiality of contingent future events, *see id.* at 238, meaning that it answers petitioner's worries about premature disclosures as well. Courts can, and do, dismiss private actions involving disclosure violations when they determine that the undisclosed information was immaterial under *Basic*. *See*, *e.g.*, *In re Lions Gate Entm't Corp. Sec. Litig.*, 165 F. Supp. 3d 1, 20 (S.D.N.Y. 2016) (§ 10(b)); *In re Ply Gem Holdings, Inc. Sec. Litig.*, 135 F. Supp. 3d 145, 149-54 (S.D.N.Y. 2015) (§ 11).

Nor will § 10(b) liability for omissions of required information lead to hindsight pleading. Warding off

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[22] *See* Langevoort, 57 Vand. L. Rev. at 1651-53 & n.42 (collecting cases).

"allegations of fraud by hindsight," *Tellabs*, 551 U.S. at 320, is the function of the element of scienter, which requires "a mental state embracing intent to deceive, manipulate, or defraud," *Matrixx*, 563 U.S. at 48. To survive a motion to dismiss, a private § 10(b) plaintiff must "plead facts rendering an inference of scienter *at least as likely as* any plausible opposing inference." *Tellabs*, 551 U.S. at 328 (interpreting the PSLRA, 15 U.S.C. § 78u-4(b)(2)). An issuer that acts with an "intent to deceive, manipulate, or defraud," *Matrixx*, 563 U.S. at 48, in misleadingly omitting required, material information from a disclosure cannot later complain of hindsight pleading when investors seek to recover for damages caused by its misconduct.

Because the materiality and scienter elements of a § 10(b) violation are tailored to address precisely the concerns petitioner raises, there is nothing to be gained — and much to be lost in terms of promoting disclosure and compensating injured investors — by narrowing the scope of deception that § 10(b) prohibits. "[I]nstead of adopting a circumscribed view of what it means for a [securities filing] to be false or fraudulent," petitioner's concerns "can be effectively addressed through strict enforcement of" the 1934 Act's "materiality and scienter requirements." *Universal Health*, 136 S. Ct. at 2002.

Moreover, even pleading a violation of Item 303 is no small matter. As interpreted by the Second Circuit in this case, "Item 303 requires the registrant to disclose only those trends, events, or uncertainties that it actually knows of when it files the relevant report with the SEC." App. 19a. Courts regularly

dismiss private actions that fail to plead facts requiring disclosure under Item 303.[23]

In all events, petitioner's concerns about over-disclosure reduce to a quarrel with the policies chosen by Congress (in the 1934 Act) and the Commission (in Regulation S-K). "Disclosure, and not paternalistic withholding of accurate information, is the policy chosen and expressed by Congress." *Basic*, 485 U.S. at 234.

2. Petitioner makes a last-ditch, unpersuasive effort (at 50-53) to relitigate the Second Circuit's conclusion that respondents pleaded a violation of Item 303.

Petitioner first asserts (at 50) that Item 303 did not require disclosure of the CityTime fraud because the contract was near completion. But petitioner knew that the CityTime problem extended far beyond the end of one contract: it exposed petitioner to potential fines or disgorgement of CityTime revenues, which exceeded petitioner's entire 2010 net income, PSAC ¶ 441 (JA234), and it jeopardized petitioner's plan to make the CityTime project a stepping stone to a new line of business valued at $2 billion, *id.* ¶¶ 106-115 (JA99-102); App. 21a. The scandal also put at risk petitioner's government-contracting business, from which it derived 97% of its revenues in 2011. JA829. As petitioner explained in its March 2011 annual report, if its "reputation or relationships with [govern-

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[23] *See, e.g.*, *J&R Mktg.*, 549 F.3d at 391-92 (§ 11 case; allegedly omitted information was not known to issuer); *Steckman v. Hart Brewing, Inc.*, 143 F.3d 1293, 1296-98 (9th Cir. 1998) (§ 11 case; slowdown in sales not a known trend); *In re Hardinge, Inc. Sec. Litig.*, 696 F. Supp. 2d 309, 327 (W.D.N.Y. 2010) (§ 10(b) case; no requirement to disclose changes to company's distribution channels because it was not a negative trend).

ment] agencies were harmed, [its] future revenues and growth prospects would be adversely affected." JA847. The factors that petitioner warned could damage that relationship included "negative publicity regarding [its] work for state and local government and commercial customers" and "subcontractor misconduct." JA848, JA863-64. By petitioner's own assessment, the CityTime scandal threatened its all-important ability to keep and win government contracts.

Moreover, four months before petitioner filed its March 2011 annual report, petitioner knew that the criminal charges against subcontractors linked to CityTime were *already* causing it to lose government business: specifically, a $118 million contract with the MTA, and a $40 million contract with New York City. *Id.* ¶¶ 355-362 (JA191-96). These are "significant" sums for petitioner, which reported that the three "most significant" declines in revenue on its various programs were all under $100 million. JA911-12. It did not matter that, at the time, neither petitioner nor its employees had been charged: on the contrary, the "unresolved" nature of petitioner's involvement was expressly cited as a reason petitioner's MTA bid was rejected. PSAC ¶ 356 (JA192).

Nor did it matter that, according to petitioner (at 11, 51), it had not been told that it was yet a "target" of an investigation. As the Commission has recognized, when a company relies on government contracting, a governmental inquiry must be disclosed under Item 303 "where, in light of the uncertainty regarding the government's inquiry, reported financial information would not necessarily be indicative of the company's future operating results or financial condition." Statement of the Commission Regarding Disclosure

Obligations of Companies Affected by the Government's Defense Contract Procurement Inquiry and Related Issues, 53 Fed. Reg. 29,226, 29,227 (Aug. 3, 1988). That is so even when the company is "not targeted in the investigation." *Id.*

In short, when petitioner filed its annual report in March 2011, it knew about: misconduct in the CityTime project; the loss of current business opportunities; the uncertainty regarding future business opportunities; the involvement of at least two employees of petitioner in the still-unfolding CityTime investigation; and the possibility of fines or disgorgement of hundreds of millions of dollars in CityTime revenue. App. 19a-20a & n.8. Petitioner's sanitized recitation of the scandal (at 10-13, 50-52) ignores those and numerous other pertinent facts alleged in the complaint, *see supra* pp. 7-13. In light of the reasonably expected impact of those facts on petitioner's business, Item 303 required disclosure. App. 19a-20a.[24] But petitioner chose not to make such a disclosure. Worse, it expressly acknowledged in its annual report that "investigations, claims, [and] lawsuits" presented "uncertainties" to the business, but it excluded any mention of CityTime from the lengthy, narrative "discussion of these items." JA928, JA1037-53.

Petitioner suggests (at 18, 52) that its deceptive omission of the CityTime scandal in its March 2011 annual report should be overlooked because it disclosed aspects of the matter "just nine weeks later."

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[24] Petitioner's citations (at 51-52) to district court decisions for the proposition that there is no "generalized duty" to disclose uncharged misconduct or a government investigation are off-point. Disclosure is required when, as here, the facts regarding the uncharged conduct or investigation trigger an SEC disclosure obligation.

But, as the Second Circuit determined, the facts alleged give rise to a "cogent" inference that, "at the time it filed its 10-K in March 2011, [petitioner] believed it had more time before prosecutors would reveal its role in the scheme and before the City formally requested reimbursement." App. 22a. If petitioner "believed that it had more time, then the benefits of concealment might have exceeded the costs as of March 2011." *Id.* (brackets omitted). Petitioner's culpability for filing a deceptive annual report in March 2011 is therefore not diminished by the fact that "the Government and the City uncovered [petitioner]'s role in the fraud sooner than [petitioner] expected and compelled an earlier-than-expected disclosure in June 2011." App. 22a-23a.

Petitioner also asserts (at 50-53) that disclosure of the CityTime scandal should be governed by a different part of Regulation S-K — namely, Item 103, which requires disclosures relating to pending or contemplated legal proceedings, *see* 17 C.F.R. § 229.103. But the MD&A requirement of Item 303 is intended to provide "in one section of a filing" a discussion "of all the material impacts upon the registrant's financial condition or results of operations, *including those arising from disclosure provided elsewhere in the filing*." 54 Fed. Reg. at 22,428 & n.14 (emphasis added); *accord* 52 Fed. Reg. at 13,717.[25] The Commission has thus rejected petitioner's premise (at 52-53) that Item 303 excludes "topics that are dealt with in other Commission disclosure requirements."

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[25] The Commission has advised that an investigation of a company that relies heavily on government contracts may fall under multiple line items, including both Items 103 and 303. *See* 53 Fed. Reg. at 29,227.

Moreover, petitioner's other premise (at 51) — that petitioner "was not required to disclose the CityTime investigation under Item 103" — is unpersuasive as well. The CityTime investigation was a "material . . . legal proceeding[] . . . known to be contemplated by governmental authorities," and not "ordinary routine litigation incidental to the business." 17 C.F.R. § 229.103.[26] Petitioner misreads (at 52) the disclosure exception in Item 103's Instruction 2. That exception applies only to proceedings involving "primarily a claim for damages." *Id.* It therefore did not apply here because criminal proceedings and other enforcement actions seeking equitable relief such as disgorgement were contemplated. *See* App. 19a n.8 ("[A]s alleged in the PSAC, by early March 2011 [petitioner] 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.").

In the months between the filing of petitioner's misleading annual report and the day it finally made a disclosure regarding CityTime, respondents purchased petitioner's stock. They did so having been told that the company's annual report complied with SEC disclosure requirements when, in fact, it did not. They did so having been informed that the company relied almost exclusively on government contracting — but without disclosure that the company's ability to compete for such contracts was in

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[26] Item 103's disclosure obligation is not limited to "pending" proceedings. It also covers proceedings not yet pending but "known to be contemplated." *See* 17 C.F.R. § 229.103 (Instr. 2) (referring to "proceedings pending *or* known to be contemplated") (emphasis added).

jeopardy. And they did so having been advised that government investigations could have devastating consequences and that the annual report included a discussion of such investigations — but without disclosure that a significant, ongoing investigation had been omitted from that discussion. The court of appeals properly construed § 10(b) and Rule 10b-5 to encompass petitioner's deception.

CONCLUSION

The court of appeals' judgment should be affirmed.

Respectfully submitted,

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